

UNIVERSIDAD COMPLUTENSE DE MADRID

FACULTAD DE CIENCIAS POLÍTICAS Y SOCIOLOGÍA

**Departamento de Derecho Internacional Público y Relaciones
Internacionales (Estudios Internacionales)**



TESIS DOCTORAL

**Energy disputes between Russia and Ukraine from
2006 to 2009: analysis of Russian's decisions in the
escalation process through the lenses of prospect
theory**

**Disputas energéticas entre Rusia y Ucrania desde el
2006 al 2009: análisis de las decisiones de Rusia en el
proceso de escalada a través de la teoría de las
perspectivas**

MEMORIA PARA OPTAR AL GRADO DE DOCTOR

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Eric Pardo Sauvageot

Director
Antonio Marquina Barrio

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TESIS MENCIÓN EUROPEA



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ENERGY DISPUTES BETWEEN RUSSIA AND UKRAINE FROM
2006 TO 2009:

ANALYSIS OF RUSSIA'S DECISIONS IN THE ESCALATION PROCESS
THROUGH THE LENSES OF PROSPECT THEORY

Doctorando:

Eric PARDO SAUVAGEOT

Licenciado en Ciencias Políticas y de la Administración

Máster en Relaciones Internacionales

Director de Tesis:

Antonio MARQUINA BARRIO

Catedrático de Relaciones Internacionales

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LIST OF ACRONYMS

bcf: Billion cubic feet.

bKWh: Billion Kilo-Watt per hour.

bcm: Billion cubic meters.

bbl: (oil) Barrel.

bt: Billion ton.

BTC: Baku-Tbilisi-Ceyhan (Pipeline).

BTE: Baku-Tbilisi-Erzurum (Pipeline).

CIS: Confederation of Independent States.

CNPC: China National Petroleum Corporation.

EBRD: European Bank for Reconstruction and Development.

ECT: Energy Charter Treaty.

FSB: *Federalnaia Sluzhba Bezopasnosti*.

FSU: Former Soviet Union.

GDF: *Gaz de France*.

GDP: Gross Domestic Product.

GTS: Gas Transportation System.

IMF: International Monetary Fund.

JV: Joint Venture.

LNG: Liquefied Natural Gas.

MOL: from: *Magyar Olaj- és Gázipari Nyilvánosan működő Részvénytársaság*, (Hungarian Oil and Gas Public Limited Company).

Mtoe: Million of ton of oil equivalent.

MWh: Mega Watt per hour.

NEGP: North European Gas Pipeline.

NKRE: National Regulatory Commission of Electrical Energy.

OblHazy: Regional gas distributor.

ÖMV: *Österreichische Mineralölverwaltung* (Austrian Oil Administration).

PPP: Purchasing Power Parity

RUE: RosUkrEnergo.

RWE: *Rheinisch-Westfälisches Elektrizitätswerk* (Rhineland-Westphalia Electricity Network).

SBU: *Sluzhba Bespeki Ukraïni*.

TGI: Turkey-Greece-Italy Interconnector.

Mtoe: Million tons per oil equivalent.

tb: Thousand barrels.

tcm: Thousand cubic meters.

Tcf: Trillion cubic feet.

Tcm: Trillion cubic meters.

TPES: Total Primary Energy Supply.

TurkmenNefteGaz: Turkmenistan's Oil and Gas State Company.

WTO: World Trade Union.

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This work is the result of years of effort studying the complex world of energy in the Eurasian space, its complicated relations with Europe, and in particular, the intricacies of the explosive dyad of Russia-Ukraine. I may say with the benefit of hindsight, that my focus on Russia and the post-soviet space started as early as in my high school years, when I decided to learn Russian. This took me to spend three summers in a host family in Saint Petersburg, where I made the progress necessary as to analyze all materials in Russian used for this study. My gratitude should therefore go first to the family Ledovskikh, who through their dedication, inadvertently first paved the way that led me here.

My subsequent studies did not necessarily predispose me to go into graduate school. Having majored in Political Science in the Universidad Complutense de Madrid (UCM), I must say that my very initial interest was set on a future career as civil servant in the European Union or as a Diplomat in the Spanish Foreign Office. Nothing thereof happened, as I realized my calling was to remain in academia and to become a professor. Thus I decided to start a Master of International Relations in my Alma Mater, where I would subsequently work on my Phd thesis.

Still, I was not necessarily destined to choose the post-soviet space in general and the topic of Russia-Ukraine energy disputes in particular, as the realm where my studies would unfold. My experience in Singapore (where I worked as intern in the ASEF Foundation after my undergraduate studies) and my yearning for studying in Japan (which I did as exchange student within my master studies) predisposed me at the time, to focus my future Phd studies on Asia. However, my linguistic knowledge of Russian determined that Russia would be part of the picture. My acknowledgements must therefore go to these people that had an influence on me in those formative years, Ramón Molina from ASEF, professor David García Cantalapiedra from UCM, who first provided me with the suggestion of doing my Master thesis on energy relations between Russia and Japan, professor Yuji Kurokawa, my tutor in Nihon University during my stay in Japan and professor Yukiko Koshiro, one of the people most responsible for instilling in me the pleasure of research.

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THESIS SUMMARY IN SPANISH

Introducción

La presente tesis doctoral busca explicar las decisiones de la Federación Rusa y de Gazprom en la gestión de tres disputas energéticas con Ucrania (enero del 2006, marzo del 2008 y enero del 2009) a través de la teoría de las perspectivas. La hipótesis de base de nuestra tesis es que las decisiones de escalar o des-escalar cada una de las disputas respondía al grado de empeoramiento del status quo en que se encontraba la Federación Rusa y en la mayor asunción de riesgos en consecuencia de ello. Además, se valorará en la medida de lo posible, las fluctuaciones en el riesgo objetivo.

Nuestra tesis doctoral se enmarca dentro del tema genérico de las disputas energéticas en el espacio post-soviético. El interés que ofrece al investigador de las relaciones internacionales tal región, reside en el hecho de que la disolución de la Unión Soviética (URSS) y la caída del Telón de Acero dejó expuestas complejas relaciones de interdependencia energética entre las nuevas repúblicas post-soviéticas y los países consumidores de hidrocarburos. Así, lo que era un espacio común dentro de la Unión Soviética y del espacio económico de la CMEA (siglas en inglés de "Council for Mutual Economic Assistance"), quedó fragmentado entre los países de Europa Central que escapaban a la órbita de Moscú y las nuevas repúblicas post-soviéticas (nueva "Confederación de Estados Independientes", CIS en sus siglas en inglés). De resultas de ello, la relación de interdependencia entre la antigua URSS y los países consumidores, tanto de Europa central como de Europa occidental se veía complicada por un tercer actor: los países de tránsito.

La relación triangular que surge entre los consumidores europeos, los países productores del espacio CIS (principalmente la Federación Rusa, pero también países de Asia Central) y los nuevos países de tránsito se caracteriza desde los inicios por un notable desequilibrio que hace que los patrones de interdependencia existentes sean notablemente asimétricos. En este sentido, tal asimetría se hace manifiesta en el plano del gas natural, ello por una serie de razones: no encontramos un mercado integrado a nivel mundial de gas natural. Así, existe una clara diferencia con el mercado del petróleo, integrado a nivel mundial. En cambio, el gas natural tiene una elevada dependencia de los gasoductos como medios de transporte, mientras que el petróleo, por el contrario, depende principalmente del transporte marítimo, más flexible. Al mismo tiempo, el gas natural presenta mayores dificultades para su

almacenamiento. Estos elementos exponen a los países consumidores a una mayor vulnerabilidad en caso de cortes de gas natural.

Además de estas características, como ya hemos mencionado más arriba, el hecho es que dentro de la dependencia de una serie de países de tránsito, el espacio post-soviético presentaba una notable asimetría: si los dos principales países de tránsito para el gas natural ruso tras la caída de la URSS eran las nuevas repúblicas independientes de Bielorrusia y Ucrania, la práctica totalidad del gas natural exportado por el monopolio ruso Gazprom pasaba por el segundo país. Además, la complejidad del nuevo panorama energético en el espacio post-soviético hacía que esta interdependencia resultase particularmente explosiva. Ello se debía a la particularidad de que Bielorrusia y Ucrania, además de países de tránsito para el gas natural ruso hacia otros países de Europa central y occidental, tenían una enorme dependencia como consumidores de Gazprom, ya fuese para el consumo de gas ruso o de gas de Asia Central (principalmente Turkmenistán). Esto tuvo una clara expresión en las disputas energéticas entre la Federación Rusa y Ucrania en la década de los 90, donde los conflictos sobre precios y deudas se tradujeron en cortes de gas de Gazprom y Turkmenistán hacia Ucrania, que llevaron a su vez a que Ucrania extrajese volúmenes de gas natural en tránsito a través de su territorio, destinado para otros consumidores.

Objetivos

Los objetivos de esta tesis doctoral están centrados principalmente en un actor dentro de este complejo entramado de interdependencia energética: la Federación Rusa. La razón de ello es la siguiente: como país productor, en relación con numerosos países consumidores y dependiente de países de tránsito, se enfrenta a un dilema en lo que a su gestión de disputas energéticas con países de tránsito se refiere. Lo hemos podido ver más arriba en relación con las disputas energéticas en los años 90: toda decisión de someter a cortes de suministro de gas natural a un país de tránsito (por su carácter igualmente de país consumidor) puede acarrear perturbaciones en el flujo de gas natural para otros países consumidores. El dilema estribaría en los costes en reputación ante la UE que ello provocaría a Gazprom y al gobierno ruso por extensión. Ese es un factor de negociación con el que el país de tránsito puede razonablemente jugar.

La Federación Rusa como actor internacional y la respuesta al dilema de disputas energéticas

Nos interesa centrarnos en tal aspecto como estudio de caso de la Federación Rusa como actor internacional. En términos generales, buscamos contribuir a esclarecer cómo se comporta la Federación Rusa y en qué medida reacciona como expresión de poderío o como respuesta a desafíos; una Rusia activa y revisionista del status quo internacional es muy diferente de un actor reactivo y que busque preservar tal status quo. Para ello, vamos a elegir una secuencia de disputas que cumplan el requisito de presentar una situación de dilema como la descrita en la sección superior con el fin de ver cuáles fueron las decisiones tomadas por parte de la Federación Rusa.

Por las razones ya esgrimidas, encontramos que las disputas energéticas que impliquen gas natural y la relación entre la Federación Rusa y Ucrania son las más susceptibles de presentar la situación de dilema que buscamos. En cuanto a la secuencia óptima, encontramos que se trata de aquella formada por tres disputas energéticas entre Rusia y Ucrania, acaecidas en enero del 2006, marzo del 2008 y enero del 2009. Un elemento adicional que hace interesante este periodo, es el hecho de que se da en una época en que el control del gobierno ruso sobre Gazprom es más intenso que en etapas anteriores. La presunción de control por parte del gobierno sobre el proceso en que se desarrollan las disputas está plenamente justificada. Sin embargo, lo más interesante de estas tres disputas, es que presentan tres patrones muy distintos:

Tres disputas energéticas y tres patrones de escalada diferentes

Disputa de enero del 2006

En enero del 2006, Gazprom corta el gas natural a Ucrania como resultado del fracaso de las negociaciones sobre nuevos precios. Al no haberse firmado un nuevo contrato para el mes de enero, Gazprom toma tan fatídica decisión. Como resultado de ello, Ucrania empieza a extraer gas natural de los flujos de gas natural exportados a través de su territorio. Así tiene lugar una crisis de suministro en los países más dependientes de Europa Central. Ante este panorama, Rusia decide restaurar los flujos de gas natural a Ucrania y proseguir las negociaciones hasta que se alcance un acuerdo.

Disputa de marzo de 2008

En marzo del 2008, ante una disputa centrada en el endeudamiento del monopolio energético ucraniano Naftohaz, Gazprom establece cortes parciales hasta reducir el flujo a Ucrania en la mitad. Sin embargo,

Gazprom no va más allá y por el contrario, restablece el flujo normal tras dos días, dejando que prosigan las conversaciones con normalidad hasta que se alcanza un acuerdo.

Disputa de enero de 2009

Finalmente, en enero del 2009, con la tercera de las disputas, se alcanza un nuevo patrón de disputa. Habiéndose empezado de forma similar a enero del 2006, la gran diferencia se da con la respuesta por parte rusa a la extracción de gas natural de Ucrania de los flujos de gas en tránsito: en vez de restablecer el flujo de gas natural para consumo ucraniano y proseguir las negociaciones, Gazprom impone un embargo progresivo a todo gas natural que cruce el territorio ucraniano. De tal manera, se imposibilita que Ucrania extraiga gas natural, si bien a cambio, se recrudece de forma significativa la crisis energética que la disputa estaba provocando en los países dependientes del gas natural ruso. En esta disputa, no se restablece el flujo normal hasta que se alcanza un acuerdo.

Sobre la disputa de 2014

Una nueva fase de turbulencias se inicia en 2014 con la crisis del Euromaidán. Es desde el 16 de junio hasta el 2 de diciembre cuando tiene lugar la disputa más larga entre la Federación Rusa y Ucrania, con un corte de gas sostenido durante todo este periodo. Tal disputa se queda fuera de esta tesis doctoral por no haber derivado en crisis energética hacia otros países consumidores. El hecho de que la importancia de los flujos que atraviesan Ucrania se había reducido en esta época y que gran parte de la disputa tuvo lugar en época estival y por tanto de bajo consumo, puede explicar esta circunstancia, así como el hecho de que el dilema de sufrir costes en reputación fuese mucho más reducido, si no inexistente.

Proceso de escalada y su aplicación a las disputas energéticas

El diferente patrón que presenciamos en las tres disputas objeto de estudio nos presenta con la pregunta de por qué la Federación Rusa y Gazprom tomaron decisiones diferentes en cada una de las disputas, causando diferentes patrones de escalada. El proceso de escalada ha sido aplicado en el estudio de los fenómenos bélicos y pensamos que es perfectamente aplicable a este estudio. El proceso de escalada, que podemos encontrar perfectamente teorizado por Kilgour y Zagare, consiste en la disyuntiva en la que se encuentran una serie de actores ante los llamados nudos de decisión: cada actor ha de decidir si da un paso para desafiar el status quo o mantenerlo; si un actor (A) está insatisfecho con tal status quo, puede decidir abstenerse y situarse en él, o desafiar a otro actor (B) con el fin de cambiarlo. En el próximo nudo de decisión, el actor desafiado (B) ha de decidir si se somete a las demandas del primer actor (A) con el

fin de retornar pacíficamente a un nuevo status quo, o de resistir a tales demandas. En último término, dependiendo de las preferencias de los actores, el último nudo de decisión implicaría declarar o no, la guerra, el último estadio dentro del proceso de escalada.

Viendo cómo se desarrollaron las disputas energéticas objeto de estudio, podemos trasponer perfectamente el esquema de escalada a tales disputas. Los nudos de decisión a los que Gazprom y el gobierno ruso debían de hacer frente son completamente reconocibles en toda ocasión en la que había de tomarse la decisión de establecer un corte de gas natural y de cómo responder a las perturbaciones en los flujos de tránsito provocadas por Ucrania. Establecida pues, la idoneidad del instrumento del proceso de escalada para el estudio de las decisiones rusas en nuestras tres disputas energéticas, cabe destacar la aportación como herramienta interpretativa de la teoría de las perspectivas.

Teoría de la disuasión y lógica de espiral

Hay que apuntar que el proceso de escalada, tal y como ha sido teorizado hasta el momento, se basa en la teoría de la disuasión. Tal teoría se sustenta a su vez en la teoría de la utilidad esperada y de la elección racional. Según sus postulados, cualquier actor, como actor racional, busca maximizar sus beneficios y se decantará por la opción óptima en este sentido. Así, según la teoría de la disuasión, cualquier amenaza creíble por parte de un actor (A) debería servir para disuadir a otro actor (B) de llevar a cabo acciones agresivas. Esto valdrá indistintamente de que la disuasión sea realizada por parte de un estado agresor o defensor: ante una agresión creíble, un estado defensor se someterá, mientras que ante una defensa creíble, cualquier agresor cejará en su empeño.

Sin embargo, existen ejemplos que escapan a la lógica de la disuasión y que parecen seguir lo que otros autores, como Robert Jervis, han venido a llamar lógica de la espiral. En esta lógica, que diversos estudios han logrado identificar a lo largo de la historia, ocurre exactamente lo contrario que lo que la teoría de la disuasión prevería: ante una amenaza creíble, un actor, lejos de amilanarse, profundiza en su agresión o se defiende hasta las últimas consecuencias. Se origina así una espiral que en último término lleva al conflicto. La existencia de la llamada lógica de espiral pone pues en duda la universalidad de la teoría de la disuasión como sustento para explicar los procesos de escalada. Por esa razón, esta tesis doctoral va a asumir la teoría de las perspectivas como herramienta analítica. La teoría de las perspectivas, tal y como explicamos más abajo, vendría a conciliar la contradicción entre la teoría de la disuasión y la lógica de espiral, complementando la teoría de la utilidad esperada y la elección racional.

Teoría de las perspectivas y su aplicabilidad al presente estudio: actitud ante el riesgo y factor de riesgo

La novedad de la teoría de las perspectivas, según los estudios de Daniel Kahneman y Amos Tversky, consiste en observar los comportamientos de un actor bajo estudio, en condiciones de riesgo. Los resultados mostraban que según las circunstancias, un mismo actor podía mostrarse conservador, es decir, que rehuía el riesgo, u osado, es decir, que aceptaba gustosamente asumir riesgos. Por lo general, un actor con un status quo satisfactorio, rehuía apostar por ganancias que entrañaban el riesgo de pérdidas que empeorasen tal status quo. Ello parecía responder a los presupuestos de la teoría de la utilidad esperada. Sin embargo, cuando se trataba del mismo actor con un status quo insatisfactorio, la actitud tendía a cambiar: esta vez sí se tendía a asumir riesgos con tal de obtener unas ganancias que corrigiesen el status quo. En resumidas cuentas, un mismo actor era conservador ante los riesgos cuando percibía el status quo como satisfactorio, pero se volvía osado en cuanto a asumir riesgos cuando, al contrario, percibía tal status quo como insatisfactorio.

La teoría de las perspectivas pronto empezó a ser aplicada en una serie de estudios en el campo de las relaciones internacionales. Aquellos actores que perseguían ganancias que añadir a un status quo satisfactorio, cejaban en su empeño si los riesgos eran excesivos toda vez que se enfrentasen a una disuasión creíble; la disuasión, con tales actores, y no el apaciguamiento, funcionaría. Sin embargo, se observó que actores que veían su status quo sufriendo un deterioro, eran precisamente susceptibles de asumir riesgos con tal de lograr restablecer tal status quo. Se originaban reacciones si las demandas de tales actores no eran atendidas; disuadir a tales actores tendía consecuencias negativas, mientras que el apaciguamiento sería la estrategia más recomendable.

¿Cuál es la utilidad de la teoría de las perspectivas a nuestro estudio? El factor de riesgo inherente a este tipo de disputas, vista la incertidumbre sobre la reacción, tanto de Ucrania, como de los países miembros de la Unión Europea, hace aconsejable la aplicación de la teoría de las perspectivas. Al estudio de los cambios en el status quo, este estudio añade otra variable, que es el riesgo mismo. Si las variaciones del status quo pueden explicar por qué ante riesgos similares un actor puede decidir asumirlos o no, no hay que perder de vista la variación en el riesgo. En este sentido, el principal riesgo, que es la reacción crítica hacia Rusia por parte de los países consumidores miembros de la UE a los efectos de una disputa energética, podría medirse razonablemente a través de la reacción tanto de las instituciones europeas, como los países miembros, a tales disputas ¿qué lección extrajeron estos actores de la primera disputa de enero del 2006? Si la respuesta fue promover proyectos de diversificación energética que buscasen reducir la dependencia de Gazprom (véase, gasoducto Nabucco), podríamos decir que la

conclusión extraída fue que es la Federación Rusa el elemento problemático; la lección que podría extraer a su vez la Federación Rusa, ante posteriores disputas, es que el riesgo de costes de reputación es elevado. En cambio, si la respuesta fue promover proyectos de diversificación energética que buscasen reducir la dependencia de los países de tránsito (véase Nord Stream y South Stream), podríamos decir que la conclusión extraída fue que es Ucrania el elemento problemático; la lección, pues, que podría extraer a su vez la Federación Rusa, ante posteriores disputas, es que el riesgo de costes de reputación es bajo.

A la vista de los diferentes patrones de escalada en cada disputa, se plantea la pregunta de en qué medida los cambios en el status pudieron modificar la actitud ante el riesgo de la Federación Rusa y así influir en sus movimientos en cada nudo de decisiones y en qué medida los cambios en el factor riesgo (medido a través de los proyectos de diversificación) pudieron tener igualmente influencia en tales decisiones. Las dos variables independientes serán pues los cambios en status quo y el factor de riesgo, siendo la variable dependiente y objeto de estudio aquí, la variación en el proceso de escalada de cada una de las disputas objeto de estudio. La hipótesis de trabajo es que efectivamente, cambios en el status quo, modificando la actitud ante el riesgo de la Federación Rusa, así como cambios en el factor de riesgo mismo, incidieron sobre las decisiones tomadas en tales disputas.

Resultados

Los resultados obtenidos tras haber realizado el estudio son los siguientes:

En primer lugar, tras la parte introductoria en la que se expuso el marco teórico y la revisión bibliográfica (capítulos 1 y 2) y tras una parte descriptiva (capítulos 3, 4 y 5) explicando los sectores energéticos de Rusia y Ucrania y las relaciones energéticas en el complejo triángulo Rusia-Ucrania-UE, la parte empírica de las tres disputas, a la que se dedicó un capítulo para cada una (capítulo 6, disputa de enero del 2006, capítulo 7, disputa de marzo del 2008 y capítulo 8, disputa de enero del 2009), nos permite obtener resultados en cuando a los cambios en el status quo se refiere:

El primer paso consistió en determinar quién había ganado cada una de las disputas. Esta información era esencial, pues las diferencias en el proceso de escalada podrían haberse dado no tanto por decisiones cambiantes por parte de la Federación Rusa, sino por diferentes grados de resistencia por parte de Ucrania. En este sentido, los primeros resultados apuntaban claramente a que no era el caso; efectivamente, tras un pormenorizado análisis de cada uno de los acuerdos alcanzados que ponían fin a las

disputas, podemos ver que Moscú optó por acuerdos dispares, en lo que a los beneficios alcanzados en cada uno de ellos se refiere. Si en enero del 2006 y marzo del 2008 Rusia acabó aceptando acuerdos de compromiso o que incluso empeoraban su situación, en enero del 2009, la disputa no acabó hasta que se logró un acuerdo plenamente favorable. Tales resultados refuerzan la pregunta de por qué desde Rusia se tomaron decisiones diferentes y abren así, la puerta a considerar nuestra hipótesis.

Así, el segundo paso consistió en considerar qué cambios se dieron en el status quo que hubiesen podido incidir en un diferentes grados de asunción de riesgos por parte de la Federación Rusa en cada una de las disputas. En este sentido, se han encontrado valiosos resultados, centrados principalmente en los aspectos económicos, aunque sin perder de vista los factores más estrictamente políticos.

Observamos que un aumento del coste de oportunidad de mantener subsidiados los precios del gas natural para Ucrania durante el año 2005 explicaría por qué Gazprom llegó al punto de provocar una disputa energética, si bien por parte de Rusia no se llegó al extremo de querer asumir el riesgo de proseguir la disputa una vez que Ucrania demostró no querer aceptar las condiciones de Gazprom. Un empeoramiento del status quo, a causa de la acumulación de deudas, explicaría de nuevo otra disputa, la de marzo del 2008, en la que de nuevo, la Federación Rusa mostraba preferencias por llegar a acuerdos de compromiso antes que proseguir la disputa con el fin de imponer sus condiciones. Finalmente, la disputa de enero del 2009, la más dura de todas, en la que se llega al mayor punto de escalada y donde Gazprom no pone fin a la disputa hasta lograr imponer sus condiciones, corresponde a un contexto muy difícil para la Federación Rusa, dada la crisis económica y las pérdidas que ello acarreaba, unido al menor margen derivado del aumento de precios del gas natural de Asia Central, comprado por Gazprom pero consumido por Ucrania. Ello podría explicar por qué el sempiterno problema de las deudas bloqueó las conversaciones sobre precios para el año 2009 con los funestos resultados de una nueva disputa.

Los factores políticos también parecen haber operado, si bien por lo general dentro del marco de los intereses económicos subyacentes. Así, parece que la reorientación política de la nueva administración Yushchenko a partir del 2005 habría sido determinante para que el coste de oportunidad de mantener los precios subsidiados para Ucrania, en comparación con los crecientes precios a nivel internacional, resultase inaceptable. Al mismo tiempo, la elevación de los problemas de endeudamiento por parte de Gazprom en causa suficiente como para forzar cortes de gas (tal fue el caso en marzo del 2008) surge a la víspera de la llegada del segundo gobierno de Yulia Timoshenko. Si bien parece haber razones económicas subyacentes (respuesta a los planes del nuevo gobierno y miedo a que no se paguen las deudas existentes), la politización de estos elementos económicos no puede perderse de vista. El que el

pago de una nueva deuda fuese condición para iniciar las conversaciones sobre precios en los últimos meses del 2008, bien podría responder a razones estrictamente económicas, como apuntábamos más arriba, o tener un elemento de politización igualmente, como reacción a un actor identificado como hostil.

Una vez que se extrajeron conclusiones de los cambios en el status quo, teniendo en cuenta tanto los elementos económicos como políticos, el capítulo 10 analizó los proyectos de diversificación (Nabucco por un lado y Nord Stream y South Stream por otro) para intentar determinar si hubo variaciones en el factor de riesgo. Los resultados en este apartado no pueden resultar concluyentes, pues el desarrollo de los proyectos de diversificación, contrapuestos en sus objetivos de diversificación, se desarrollaron con relativa indeterminación en el periodo 2006-2009. No se puede concluir que la Federación Rusa tuviese la información suficiente como para extraer conclusiones sobre significativos cambios en el factor de riesgo.

Conclusiones

En definitiva se puede concluir que tal y como nuestra hipótesis suponía, cambios en el status quo, (la primera variable independiente) relacionados con un empeoramiento de este, tienen una clara correlación con una mayor asunción de riesgos por parte de la Federación Rusa con el fin de alcanzar una serie de objetivos e influyen poderosamente en la variable dependiente, es decir, los diferentes patrones de escalada. El caso más manifiesto sería el de la disputa de enero del 2009. Al mismo tiempo, el desarrollo de los proyectos de diversificación no aporta suficiente información como para asumir una influencia significativa de la segunda variable independiente sobre nuestra variable dependiente.

En lo que a la Federación Rusa como actor en la escena internacional se refiere, este estudio no parece confirmar la clásica imagen de Rusia como un estado agresivo y revisionista, en pos de maximizar su poder. La actitud más agresiva por parte de nuestro actor, que podemos encontrar claramente en la disputa de enero del 2009, responde a una clara deterioración del contexto en que se encontraba, y tiene un cariz más reactivo que activo. Esto no tiene por qué ser extrapolable a otros ámbitos de la acción exterior de la Federación Rusa. Sin embargo, resulta ser una muy valiosa aportación al persistente debate sobre la naturaleza de este controvertido actor.

Por último, cabe destacar la importante contribución sobre uno de los puntos oscuros de las relaciones energéticas entre Rusia y Ucrania, que es el factor de las empresas intermediarias. En nuestro

estudio, RosUkrEnergo goza de un enorme protagonismo durante todo el periodo. Precisamente, esta empresa, dirigida a partes iguales por Gazprom y un conglomerado empresarial ucraniano, con Dmitro Firtash a su cabeza, ha sido (y sigue siendo) objeto de debate en cuanto a si era o no un instrumento estratégico de Gazprom. Siempre con las debidas prevenciones, visto el tipo de información disponible y que hemos manejado aquí, creemos que se logra presentar un relato plausible sobre los intereses relativos de la parte rusa en la existencia de este tipo de actores que relativiza pues mucho la supuesta victoria de Gazprom en enero del 2006, a la vista sobre todo, tanto de los intereses ucranianos en tal empresa, y del hecho de que la Federación Rusa se deshizo de tal empresa en enero del 2009, ocasión de una clara victoria en la disputa que en tal ocasión, como hemos visto, tuvo lugar, en vez de reforzar aún más su papel.

THESIS SUMMARY IN ENGLISH

Introduction

This Phd thesis seeks to provide explanations for decisions taken by the Russian Federation and by Gazprom in the management of three energy disputes with Ukraine (January 2006, March 2008 and January 2009), and that, through the lenses of prospect theory. Our hypothesis is that decisions to either escalate or de-escalate each of the three disputes responded to the degree of worsening of the status quo in which the Russian Federation located itself and in consequence, to the higher degree of risks assumed. In addition to this, we will value in the measure of possible, how the objective risk fluctuated.

Our Phd thesis is framed within the generic topic of energy disputes in the post-Soviet Space. The interest this region offers to researchers in international relations is based on the fact that the dissolution of the Soviet Union and the fall of the Iron Curtain left exposed a set of complex interdependencies between the new post-Soviet republics and consumer countries of hydrocarbon resources. Thus, what had been a common space within the Soviet Union and the economic space of the CMEA (Council for Mutual Economic Assistance), collapsed, leaving Central European countries free of Moscow's grip and a set of new post-Soviet Republics (new "Confederation of Independent States", CIS). As a result, the relation of interdependency between the former Soviet Union and consumer countries, be it from Western or Central Europe, became more complex and complicated due to the emergence of a new third actor: transit countries.

The triangular relation that emerged between European consumers, producers within the CIS space (mainly the Russian Federation, but also countries from Central Asia) and the new transit countries, was characterized from its very inception by a remarkable unbalance. As a consequence, existing patterns of interdependency resulted to be very asymmetrical. In this respect, such asymmetry became more manifest concerning natural gas, and that, for the following reasons: we do not find an integrated market at the world level yet, as opposed to petrol. The main consequence thereof is that contrary to petrol, which depends on more flexible maritime transportation, natural gas is highly dependent on pipelines. In addition to that, natural gas is more difficult to store. These elements make consumers of natural more vulnerable to cut-offs of natural gas.

In addition to these characteristics, as mentioned above, the fact is that within the reality of dependency on a set of transit countries, the post-Soviet space presents an important asymmetry: if the

two main transit countries for Russian natural gas after the fall of the Soviet Union were the newly independent republics of Belarus and Ukraine, most of the natural gas exported by Gazprom went through the latest country. Besides this, the complexity of the new energy panorama in the post-Soviet Space made this interdependency particularly explosive. That was due to the particularity that both Belarus and Ukraine were at the same time dependent of Gazprom, be it for consumption of Russian natural gas or for the transit through Gazprom's facilities of Central Asian (mostly Turkmen) natural gas. This had a clear translation in the energy disputes between the Russian Federation and Ukraine in the decade of the 90s, where conflicts on prices and debts degenerated in gas cut-offs by Gazprom and Turkmenistan and which then led Ukraine to siphon gas out from the flows of natural gas that transited its territory, but meant for other consumers.

Objectives

The objectives of this Phd thesis center on one actor in particular within the complex pattern of energy interdependence: The Russian Federation. The reason for this is the following: as a producer country, bounded to many consumer countries and dependent on transit countries, Russia faces a dilemma whenever energy disputes with transit countries take place. We had the chance to see this above, when we mentioned the energy disputes in the 90s: every decision to impose cut-offs of natural gas to a transit country (due to its simultaneous condition of consumer) can cause disturbances in the flow of natural gas to other consumer countries. The dilemma concerns reputational costs for Gazprom, and for the Russian government in extension. This a factor with which the transit country can arguably play in negotiations.

The Russian Federation as an international actor and its reaction to the dilemma of energy disputes

We are interested on this aspect as case study of the Russian Federation as an international actor. In general terms, we endeavor to clarify how the Russian Federation behaves and in what measure it responds as an expression of its power or as a response to challenges: a Russian Federation who actively seeks to review the international status quo is very different than a reactive actor that aims at preserving the status quo. Therefore, we will choose a sequence of disputes that present situations where the dilemma described in the section above in order to see which were the decisions taken by the Russian Federation.

For the reasons put forward above, we find that energy disputes involving natural gas and the relation between the Russian Federation and Ukraine are those more liable to present the situation we are seeking. The optimal sequence can be found by three energy disputes that took place in January 2006, March 2008 and January 2009. An additional element which makes this period so relevant is the fact that at that time the government's control on Gazprom was more intense than in the past. The presumption of control from the side of the government of the process which led to the disputes seems fully justified. However, the most interesting aspect of these three disputes is that they present each different patterns:

Three energy disputes and three patterns of escalation

Dispute of January 2006

In January 2006, Gazprom cuts off natural gas to Ukraine as a result of the failure of negotiations on new prices. With no new contract having been signed at the start of January, Gazprom took thus the fateful decision. As a result thereof, Ukraine started extracting natural gas from the flows of natural gas exported through its territory. Thus an energy crisis started in those consumer countries most dependent on Gazprom's natural gas. Facing such situation, Russia decides to restore flows of natural gas to Ukraine and to pursue negotiations until an agreement is reached.

Dispute of March 2008

In March 2008, facing indebtedness by the Ukrainian energy monopoly Naftohaz, Gazprom imposes partial gas cut-offs and reduces the supply to Ukraine by half. However, Gazprom does not go further than that and on the contrary, reestablishes normal flows two days after the start of the dispute, allowing for conversations to continue until an agreement is reached.

Dispute of January 2009

Finally, in January 2009, the third dispute in our sequence, a new pattern of dispute is reached. Having started in the same fashion as its predecessor of January 2006, the big difference comes from the way the Russian side responds to the extraction of natural gas by Ukraine from the flows of natural gas in transit: instead of reestablishing the flow of natural gas for Ukrainian consumption and then continue negotiations, Gazprom imposes a progressive embargo for all natural gas crossing Ukrainian territory. As a consequence, Ukraine cannot extract any additional flows, but the energy crisis in most dependent consumer countries provoked by the dispute worsens significantly. In this dispute, the situation does not come back to normalcy until a final agreement is reached.

On 2014 dispute

A new era of disturbances starts in 2014 in the wake of the Euromaidan crisis. From 16th June to 2nd December takes place the longest dispute to date between the Russian Federation and Ukraine, with a gas cut-off sustained during the whole period. Such dispute remains outside of this Phd thesis for not having degenerated into an energy crisis for other consumer countries. The fact that the importance of natural gas flows that transit Ukraine had reduced at that time, along with the fact that most of dispute took place outside of the heating season and thus, during a period of low energy consumption, may explain this circumstance and the fact as well, that the dilemma of suffering reputational costs was much lower, if not none existent.

Escalation process and its application to the energy disputes

The different pattern that we may witness in each of the three disputes which are the object of study here, provoked different escalation patterns. The escalation process has been applied to the study of war and we consider it can perfectly be applied to this study. The escalation process, which we can find perfectly theorized in Kilgour and Zagare, consists in the dilemma faced by a series of actors when locates in the so-called nodes of decision: each actor has to decide whether it wants to challenge the status quo or to maintain it; if an actor (A) is unsatisfied with the status quo, it may decide either to abstain from changing it, or challenge another actor (B) in order to change it. In the next node of decision, the challenged actor (B) had to decide whether it will submit to the first actor's demands (A) and to go back peacefully to a new status quo or to resist such demands. Ultimately, depending on the actors' preferences, the last node of decision may lead to war, the last stage in the escalation process.

Considering how the energy disputes unfolded, we may perfectly transplant the scheme of escalation to these disputes. The nodes of decision to which Gazprom and the Russian government had to face match the decisions in a escalation process whenever they had to decide to impose a gas cut-off and whenever they had to face the consequences of disturbances in the transit flow provoked by Ukraine. Given the suitability of the escalation process as a tool for the study of Russian decisions in our three energy disputes, we may highlight the contribution made by prospect theory as a way to interpret them

Deterrence theory and the spiral logic

We must point to the fact that escalation processes, as theorized to date, are based on deterrence theory. Deterrence theory is based on expected utility theory and rational choice. According to its tenets,

whatever actor, as a rational actor, seeks to maximize its profits and will thus tend to take decisions that favor optimal solutions. Thus, following deterrence theory, credible threats from the side of an actor (A) should deter another actor (B) to carry through aggressive actions. This should be valid irrespective of the fact whether deterrence is carried through by an aggressor or defender state: in the face of a credible aggression, a defender will submit, whereas whatever aggressor will let on when faced with a credible defense.

However, there exist examples that escape deterrence theory and which seem to follow another logic, which authors like Robert Jervis have preferred to call spiral logic. In this logic, which divers studies have identified in several historical examples, the exact contrary of what deterrence theory would predict, happens: facing a credible threat, an actor, far from being intimidated, deepens its aggression and defends to the last consequences. Thus a spiral starts that eventually leads to conflict. The existence of the so-called spiral logic puts into question the pretension of universality of deterrence theory as the basis to explain escalation processes. For this reason, this Phd thesis assumes prospect theory as the main analytical tool. Prospect theory, as explained below, offers an explanation that reconciles both deterrence theory and spiral logic, serving thus, as a complement to expected utility and rational choice .

Prospect theory and its applicability to this study: risk attitude and risk factor

The novelty offered by prospect theory, following studies by Daniel Kahneman and Amos Tversky, consists in observing behavior in conditions of risk. Results show that depending on circumstances, one same actor may assume a risk-averse or risk-acceptant attitude. In general, an actor perceiving itself in a satisfactory status quo, was risk-averse as for risk to that same status quo that prospective benefits entailed. In this respect, it seems that this goes in line with expected utility theory. However, when the same actor faced a status quo which it deemed unsatisfactory, its attitude tended to be reversed: there was a tendency to risk-acceptance in the face of risk that prospective benefits that might improve the status quo, entailed. Summing-up, one actor proved risk-averse in the face of risks when perceiving its status quo as satisfactory, whereas that same actor proved risk-acceptant in the face of risks when perceiving its status quo as unsatisfactory.

Prospect theory soon started being applied to a series of studies in the field of international relations. Those actors that sought profits to improve an already satisfactory status quo, submitted when risks proved to be excessive, namely, when faced with credible deterrence; thus, confirming deterrence theory, deterrence and not appeasement would be advisable with such actors. On the contrary, actors that

perceived their status quo as worsening were more liable to assume risks if there was a possibility to reestablish the status quo, so if faced with a refusal to see their demands attended, spiral logic would ensue. To deter such actors with credible deterrence would have negative consequences, whereas appeasement would be the most advisable strategy.

What may be the utility of prospect theory for our study? The risk inherent to this type of disputes, given uncertainty as for prospective reactions, be it from the side of Ukraine, or from the side of EU state members, makes advisable the application of prospect theory to our study. Besides analyzing the effect of changes in the status quo and how this may match higher degrees of risk-aversion or risk-acceptance, we add here an additional variable, which is risk itself. If variations in the status quo may explain why an actor changes its attitude towards risk, variations in risk should not be overseen either. In this respect, the main risk for the Russian Federation is the critical reaction from the side of EU consumer countries as a result of an energy dispute. The best way to measure that risk is to find out how did translate reactions from an energy dispute by either EU institutions or relevant EU members. In our sequence of disputes, we would ask: what lesson did these actors draw from the energy dispute of January 2006? If the answer was to promote diversification projects that aimed at reducing the EU's dependence on Gazprom (as for example, through the pipeline Nabucco), then we could conclude that the lesson was that the Russian Federation was the problematic actor; then, the Russian Federation's lesson for prospective energy disputes would be that the risk of further reputational costs was high. On the contrary, if the answer was to promote energy diversification projects that aimed at reducing dependence on transit countries (as for example, through Nord Stream and South Stream pipelines), then we could conclude that the lesson was that Ukraine represented the problematic actor; the lesson then, that the Russian Federation could extract for future energy disputes, is that the risk of further reputational costs was low.

Due to the different patterns of escalation in each of the disputes, we find justified to ask in which measure changes in the status quo modified the Russian Federation's risk attitude and in which measure they had an influence on decisions made in each of the nodes of decision. We will ask as well, in what measure changes in the risk factor (measured through the development of diversification projects) could have had an influence. The two independent variables in our study are changes in the status quo and in the risk factor. The dependent variable and our object of study here, are variations in the escalation process in each of the disputes we will analyze in this Phd thesis. Our hypothesis is that indeed, changes in the status quo, which modified the risk attitude of the Russian Federation, as well as changes in the risk factor itself, had an influence on decisions taken by the Russian side in these disputes.

Results

Results obtained after having carried through the study are the following:

In the first place, after our introductory part, where we exposed our theoretic frame and where we exposed our literature review (chapters 1 and 2) and after a descriptive part (chapters 3, 4 and 5) explaining the energy sectors in Russia and Ukraine as well as the complex Russia-EU-Ukraine triangle, the empiric part of our three disputes, to each of which a single chapter was devoted (chapter 6, January 2006 dispute, chapter 7, March 2008 dispute and chapter 8, January 2009 dispute), allowed us to obtain the following results as for what concerns changes in the status quo:

The first step consisted in determining who had won each of the disputes. This information was essential, as differences in the escalation process could have stemmed not so much from different decisions from the part of the Russian Federation, but from differing degrees of resistance from the side of Ukraine. In this respect, our first results clearly pointed that this was not the case; indeed, after a detailed analysis of each of the agreements reached to put an end to the disputes, we may determine that Moscow chose disparate agreements in each case, in what respects the benefits it offered. Thus, if in January 2006 and March 2008 Russia ended up accepting compromises from where it even ended up worse off than before the dispute had started, the dispute of January 2009 did not end until a fully favourable agreement had been reached. This reinforces the question of why the Russian side assumed different decisions and open the door to consider our hypothesis.

Our second step consisted in considering which changes had undergone the status quo that might have determined different degrees of risk acceptance from the part of the Russian Federation in each of the disputes. In this respect, we found valuable results, centered mainly on economic aspects, but never losing sight of strictly political factors.

We observed that a higher opportunity cost of maintaining prices for natural gas subsidized for Ukraine during 2005 would explain why Gazprom went as far as to provoke an energy dispute, even if this time Russia did not go as far as to assume risks to carry on with the dispute once Ukraine proved unwilling to accept Gazprom's conditions. A worsening of the status quo, due to Ukraine's indebtedness, would explain a new dispute, this time in March 2008, in which again, the Russian Federation showed its preference for a compromise rather than continue the dispute and to impose its conditions. Finally, the dispute of January 2009, the harshest of all to date, and where the highest degree is reached in the escalation process due to the fact that Gazprom did not relent until its conditions were fully met,

corresponds to one of the most difficult contexts for the Russian Federation, due to the economic crisis and due to the losses this was bringing to Gazprom, along with the lesser margin that an increase in prices for natural gas in Central Asia, purchased by Gazprom but consumed by Ukraine. This could explain why the never-ending problem of debts blocked conversations regarding natural gas pricing for 2009, with the ill-fated results of this new dispute.

Political factors also seem to have had a great influence, even if mostly within the framework of underlying economic interests. Thus, it seems that the reorientation of the new Yushchenko administration in 2005 would have been determinant for the opportunity cost of subsidies for the Ukrainian economy via low priced natural gas, compared to international prices, to become unacceptable. At the same time, debt issues became a reason enough to lead to natural gas cut-offs (as it was the case in March 2008) in the context of Yulia Timoshenko's return as Prime Minister. Even if there were clear underlying economic reasons for this (response to the new government's plans and fear of not recouping outstanding debts), the politization of this issue cannot be overseen. That the repayment of debt in a new debt episode in the last months of 2008 was linked with talks on pricing for natural gas in 2009 could have strictly economic reasons, as pointed out above. Still, the element of politization might also be present, with a reaction to an actor identified as hostile.

Once that conclusions were drawn from changes in the status quo, considering both economic and political aspects, chapter 10 analyzed diversification projects (Nabucco from one side and Nord Stream and South Stream from the other) in order to determine whether there were variations in the risk factor. Results here cannot be concluding, as the way these diversification projects unfolded, shows that they remained in a state of relative indeterminacy during the period 2006-2009. We may not conclude that the Russian Federation had sufficient information as to extract conclusions regarding significant changes in the risk factor.

Conclusions

As a summary, we may conclude that, as our hypothesis foresaw, changes in the status quo (our first independent variable), related to its worsening, have a clear correlation with a higher risk-acceptance from the part of the Russian Federation aiming at attaining a series of objectives. These changes strongly affected our dependent variable, namely, changes in the escalation pattern. The case where this had its more manifest expression, was the dispute of January 2009. At the same time, the development of

diversification projects does not provide enough information as to assume a decisive influence of the second independent variable on the dependent variable.

As for what concerns the Russian Federation as an actor in the international scene, this study does not confirm the classic image of Russia as an aggressive and revisionist actor, seeking to maximize power. The most aggressive attitude from the side of our actor, which we may clearly find in the dispute of January 2006, answers to a clear deterioration of the context in which Russia was located, and had more of a reactive character. This is not necessarily representative of how the Russian Federation behaves as an international actor in other fields. However, our results do represent a valuable contribution to the on-going debate surrounding this controversial actor .

Finally, we may highlight the important contribution of our study to one of the most obscure points in energy relations between Russia and Ukraine, which is the role played by intermediary companies. In our study, RosUkrEnergo enjoys an enormous prominence. It is precisely this company, controlled both by Gazprom and by a Ukrainian business consortium, with the businessman Dmitro Firtash at its head, which has been (and still remains) the object of a debate as for whether it was or not, a strategic instrument of Gazprom. Assuming due caution, given the sources of information that we have used here, we strongly believe that we present a plausible narrative regarding relative interests from the Russian side in what concerns the existence of these actors. What was described by some as a victory of Gazprom in January 2006 assumes a different shape in the light of Ukrainian interests linked to RosUkrEnergo, while the company was removed in January 2009, when Gazprom did clearly win that dispute, instead of reinforcing its role.

Lo que sucedió a una zorra que se tendió en la calle y se hizo la muerta

"Una zorra entró una noche en un corral donde había gallinas, y se cebó tanto (...) que encontró que ya era de día y que las gentes andaban por la calle. Cuando vio que no podía escapar salió ocultamente del corral a la calle y se tendió como si hubiera muerto. (...) pasó por allí un hombre que dijo que los pelos de la frente de la zorra, puestos en la frente de los pequeños, impiden que les hagan mal de ojo. (...) le cortó a la zorra con unas tijeras los pelos de la frente. (...) pasó otro y dijo lo mismo de los pelos del lomo; otro (...) de los de la ijada, y otros (...) de las otras partes. De modo que acabaron por trasquilarla.

***La zorra, a todo esto, no se movió, porque creía que perder el pelo no era un daño muy grande.** Después vino otro, que dijo que la uña del pulgar de la zorra era muy buena para los panadizos, y se la sacó, **sin que ella se moviera.** Al rato llegó otro, que dijo que el colmillo de la zorra era bueno para el dolor de muelas, y se lo sacó, **sin que tampoco ella se moviera.** Al cabo de un rato vino otro, que dijo que el corazón de la zorra era bueno para el dolor de corazón, y cogió un cuchillo para sacárselo. La zorra vio que si le sacaban el corazón no era esta una cosa, que como el pelo, volvería a crecer (...). **Decidida a aventurarlo todo antes que perderse, se esforzó por escapar** y consiguió hacerlo.*

Es mejor disimular todo lo que se pueda; pero si la cosa llegara a ser ofensa grande o perjuicio grave, entonces debe aventurarlo todo y no disimular.

EL CONDE LUCANOR (Infante D. Juan Manuel)

PART I: INTRODUCTION

Chapter 1: Theoretical Framework: Energy Disputes between Russia and Ukraine

1. 1. Introduction

In January 2006, consumers of Russian gas in many European countries were shocked by an energy dispute between Russia and Ukraine which severely affected supplies. As a result of a pricing dispute between the Russian gas monopoly Gazprom and its Ukrainian counterpart, Naftohaz Ukraïni (henceforth Naftohaz), the former decided to cut off supplies to Ukraine on January 1st. Immediately after such a decision, end consumers in those especially dependent Central European countries, started noticing lower pressure in the pipelines which serviced them with Russian natural gas. This led to lower levels of available supplies, while Russia and Ukraine accused each other: Russia accused Ukraine of siphoning gas off, whereas the latter accused Russia of intentionally reducing supplies so as to provoke a supply crisis in other consumer countries and blamed Ukraine instead. The dispute did not last much longer, as supplies started being restored on the 3rd January and an agreement was reached the next day. A similar pattern was repeated exactly three years later, in January 2009. However, this time the dispute reached a much bigger dimension, lasting three weeks, until the 19th January. It started on January 1st in the same fashion, with Gazprom cutting off gas as a result of the absence of agreement on prices for gas in 2009. As in January 2006, consumers of Russian gas, starting with countries in Central Europe, also reported lower than usual pressure and started facing supply problems.¹ Then as this stage had been reached, Russia decided to stop all supplies through Ukraine in order to prevent the latter siphoning gas off (as it was accused again by Russia),² establishing something which looked like a total gas embargo fully imposed on 7th January. This critical situation was not solved until a final agreement was reached between Russia and Ukraine on 19th January. What had happened during these three years, 2006 and 2009, to provoke such fierce disputes and to affect end consumers in third countries in such a critical way? This question seems warranted, and many tried to answer it, especially after January 2009.

¹ As we will see in Chapter 9, the energy crisis was particularly hard in countries of South-Eastern Europe. For an analysis of this crisis in the Balkans, see: Kovacevic, Aleksandar: "The Impact of the Russia–Ukraine Gas Crisis in South Eastern Europe", *Oxford Institute for Energy Studies* (March 2009), at <http://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG29-TheImpactoftheRussiaUkrainianCrisisinSouthEasternEurope-AleksandarKovacevic-2009.pdf> (Accessed on the 19th November 2013).

² As there will be occasion to show in chapters 6 & 8 and to further explain in chapter 9, there seems to be a substantial difference between January 2006 and January 2009 regarding the amount of gas siphoned off by Ukraine. Whereas in both disputes Ukraine claimed to be siphoning gas off in volumes equivalent to those required to power the transit system, what is called technical gas, and which Kiev claimed that Gazprom was responsible for supplying, the fact is that whereas in January 2009 Ukraine seemed to be siphoning a daily volume which matched technical needs (23tcm of gas), in January 2006 there was a report of a much more substantial fall in supplies for consumers in other countries of Eastern Europe (around 60tcm). That gives more credence to accusations of manipulations towards Ukraine in January 2006 than three years later.

The fact that a dispute like those in January 2006 and January 2009 could happen was understandable due to the complex triangular relation between Russia, Ukraine and gas consuming countries in most of the rest of Europe: Russia is the major supplier of gas both for Ukraine and for the rest of Europe. Regarding Ukraine, the country has been relying enormously on Russian gas for its supply. If Ukraine was a large gas producer at the peak time of its production, it then fell dramatically and has remained at a level of around 20bcm of gas per year.³ Consumption at the same time also underwent a dramatic reduction with the industrial collapse of Ukraine's economy with the end of the Soviet Union.⁴ As a result of both Ukraine's consumption and production patterns, the country has become dependent either on Russian or Central Asian natural gas.⁵ However, as Margarita Balmaceda stated, geographical diversification towards Turkmenistan did not solve the problem of dependence as the latter's relations with Russia, the unavoidable transit country for Central Asian gas, were determinant.⁶ At the same time that Ukraine was either directly (through Russian gas) or indirectly (through Central Asian gas) dependent on Russia, the latter was dependent on the former for most of the natural gas piped to third countries who consume Russian gas. During the time period from 2005 to 2009, roughly 80% of Gazprom's transit gas had to be transported through Ukraine.⁷ Dependence on Ukraine had been reduced from 90% at the beginning of the past decade, but plans to transport half of supplies through Belarus never materialized.⁸ Thus, the relation between Russia and Ukraine was (and remains) one of

³ Production peaked at nearly 70bcm during the decade of the 70s and then started a dramatic downward trend, stabilizing at the beginning of the 90s at around 20bcm (see: *Natural Gas and Ukraine's Energy Future*, IHS CERA, Ministry of Energy and Coal Industry of Ukraine, February 2012, Chapter 3, p. 3-1 (33), Figure 3-1, at <http://s05.static-shell.com/content/dam/shell-new/local/country/zaf/downloads/pdf/research-reports/Ukraine-Policy-Dialogue-report.pdf>).

⁴ Consumption was at a level of 120bcm in 1990 and fell to 70bcm in 2002 to see a slight increase closer to 80bcm. Since 2005 Ukraine has witnessed a gradual reduction due to fuel substitution as well as increasing efficiency and at some points, as in 2009, the onset of economic crisis pushed it to new lows of around 50bcm (see: *"Natural Gas and Ukraine's Energy Future"*, *op. cit.*, Chapter 2, p. 2-2 (26), Figure 2-2).

⁵ The proportion between Russian and Turkmen gas has been changing since the accession to independence in 1991.

⁶ Balmaceda, Margarita M. (2008): *Energy Dependency, Politics, and Corruption in the Former Soviet Union: Russia's power, oligarchs' profits, and Ukraine's missing energy policy, 1995-2006*, Routledge, London & New York, p. 72; since the moment when the first tumultuous years in Russia-Ukraine energy relations were over and debt issues solved, the energy market was reorganized around private traders ("Gazotreidery in Russian or "Hazotreideri" in Ukrainian) such as "Respublika", "Itera", "EuralTransGaz" and "RosUkrEnergo" which traded with Central Asian, mainly Turkmen gas (see: "It's a gas: funny business games in the Turkmen-Ukraine gas trade", *Global Witness* (April 2006), pp. 32-57 at http://www.globalwitness.org/sites/default/files/pdfs/its_a_gas_april_2006_lowres.pdf (Accessed on the 18th January 2013); RosUkrEnergo would eventually become from 2006 to 2008 the monopoly importer of all Ukrainian gas, (at least) almost 100% Central Asian (see chapter 6).

⁷ The remaining 20% was transported either through Belarus or shipped via the Finland Connector and the Blue Stream. Since the Nord Stream pipeline to Germany was inaugurated and started operating in November 2011 (see: <http://www.nord-stream.com/about-us/>), a new outlet exists that allows Russia to bypass Ukraine. Since then, the share of Russian gas transiting Ukraine has been reduced: the figure was down to 66% in 2010 (see: *"Natural Gas and Ukraine's Energy Future"*, Chapter 2, p. 2-3 (27), Figure 2-3).

⁸ See: Victor, David and Victor, Nadejda M.: "The Belarus Connection: Exporting Russian Gas to Germany and Poland", Baker Institute, Geopolitics of Gas, *Working Paper*, no. 26 (May 2004), at http://iisd.bakerstanford.edu/pubs/20603/Yamal_final.pdf.

interdependence.⁹ Finally, the third side of this triangular relation is constituted by European countries who both depend on Russia for gas and on Ukraine as a guarantor of safe transit and who will suffer any disruption in gas flows through Ukraine, whoever may be responsible. If global dependence of Russian gas is limited,¹⁰ there is a big imbalance between European countries themselves. While Western EU members are the biggest clients of Gazprom,¹¹ the share of Russian gas in their economies is low;¹² some of the Eastern EU members, in spite of accounting for a relatively low share of Gazprom's exports, are nevertheless very dependent on that source of supply.¹³ This energy dependence is worsened by the fact that many of these countries are not prepared to substitute for gas cut-offs in case of emergency, as January 2009 clearly showed.¹⁴ The deficiencies in gas interconnectors were manifest in the hardest hit countries.¹⁵ The other side of the coin is Russian dependence on European consumers for its energy exports, which in fact is bigger.¹⁶ Given this interdependence, the "energy weapon" used by Russia against Ukraine as an escalation of either pricing or debt disputes is liable to affect either automatically or

⁹ Balmaceda, *op. cit.*, p. 6.

¹⁰ As Pierre Noël reminded in 2008, Russian gas represented only 6,5 % of the EU primary energy supply, besides the fact that of all gas supplies to the EU, Russia's share had been halved to 40% from 80% (Noël, Pierre: "Beyond Dependence: How to deal with Russian gas", *European Council on Foreign Relations*, Policy Brief (7 November 2008), at http://ecfr.eu/page/-/ECFR-09-BEYOND_DEPENDENCE-HOW_TO_DEAL_WITH_RUSSIAN_GAS.pdf (Accessed on the 19th November 2013); the situation has been fluctuating in the latest years: the share of Russian gas in EU imports fell behind that of Norway (Umbach, Frank: "European-Russian gas partnership threatens to unravel", *Energy Post*, 30 September 2013, at <http://www.energypost.eu/european-russian-gas-partnership-threatens-to-unravel/> (Accessed on the 19th November 2013) with the latest's share amounting by then to 35% to 34% for Russia's, according to the US Congress Research Service, based on the BP Statistical Review from 2013 (see: Ratner, Michael; Belkin, Paul; Nichol, Jim and Woehrel, Steven: "Europe's Energy Security: Options and Challenges to Natural Gas Supply Diversification", US Congress Research Service (20 August 2013), p. 6, at <http://www.fas.org/spp/crs/row/R42405.pdf> (Accessed on the 19th November 2013); data from Eurogas registered however, Russia's share higher than that of Norway by a small margin (see: www.eurogas.org/uploads/media/Eurogas_Statistical_Report_2013.pdf (Accessed on the 21st May 2015). If we follow Eurogas again, Russia increased its share in 2013, accounting for around 27% of the EU's total consumption (see: "Statistical Report 2014", Eurogas, p. 6 at www.eurogas.org/uploads/media/Eurogas_Statistical_Report_2014.pdf (Accessed on the 21st May 2015), while other reports talked of as much as 30%.

¹¹ Noël, , *op. cit.*, p. 11.

¹² *Ibid.*, *Idem.*

¹³ *Ibid.*, p. 10.

¹⁴ Kovacevic, *op. cit.*, pp. 11-15.

¹⁵ As a report from Clingendael analyzed in September 2009, gas interconnectors were very underdeveloped if a common European gas market was to be set up (see: "Crossing Borders in European Gas Networks: The Missing Links", *Clingendael International Energy Programme* (September 2009), at http://www.clingendaelenergy.com/inc/upload/files/Crossing_borders_in_European_Gas_Networks.pdf (Accessed on the 19th November 2013). As the crisis showed, this lack of interconnections (besides other deficiencies such as insufficient reserves and difficulties to switch to other energy sources) in countries like Bulgaria was decisive.

¹⁶ Kropatcheva, Elena: "Playing both ends against the middle: Russia's geopolitical energy games with the EU and Ukraine", *Geopolitics*, no. 16 (2011), p. 556.

not,¹⁷ end-consumers in other countries and is thus a very difficult tool.¹⁸ The complexity of this energy triangle is such that Russia faces difficult dilemmas.

That gas disputes between Russia and Ukraine and between Russia and some other countries in the post-Soviet space would happen, was nothing new either. Similar disputes had already taken place before during the decade of the 90s between Russia and Ukraine, and apart from January 2006 and January 2009,¹⁹ there was also a small gas dispute in March 2008 provoked by debt disagreements that led for two days to partial gas cut-offs to Ukraine.²⁰ Disputes have also been frequent with Belarus, as was the case in 2004, 2007 and again in 2010.²¹ A new dispute between Russia and Ukraine took place recently from June to December 2014, lasting a record of several months, even if this time no disruptions affected supply to end consumers in the rest of Europe. It seems clear that energy disputes have always been recurrent in the post-Soviet space,²² involving both end-consumers and transit countries.²³ All disputes, which had Russia at its center as either the main supplier of fuel or as a transit country itself of Central Asian gas with a varying degree of monopsony, have raised several debates as to Russian motivations for initiating them. These debates arguably reached their high point with the gas dispute of January 2009 due to the huge (and justified) attention it attracted. As could have been expected, and as we will see in further detail in the next chapter, these debates parallel those we can find regarding Russian foreign policy in general. As is the case in the debates that have discussed Russian foreign policy after the

¹⁷ The specification of intended or unintended consequences stems from the intricacies of the way gas flows operate through Ukraine. As will be seen below in chapters 6 and 8, and as has already been mentioned above in fn. 2, a relevant issue when Gazprom stopped supplies to Ukraine was the responsibility for "technical gas". Technical gas is gas spent to fire up the transit pipelines in order for the volumes of export gas to cross Ukraine. Both in January 2006 and January 2009 Ukraine made Russia and Gazprom responsible for this gas and decided to siphon it off from Gazprom's own export gas; this can be labeled as an automatic consequence of a gas cut-off. However, as already mentioned, it seems that in January 2006, far from siphoning off technical gas, Ukraine decided to siphon off more gas than necessary, which raises the question whether that was not done on purpose to blame Gazprom in the face of European customers taken "hostage".

¹⁸ Kropatcheva, *op. cit.*, pp. 555-556.

¹⁹ These two disputes, which will be studied in Chapters 6 and 8, were analyzed before in the following articles: Stern, Jonathan: "Natural gas security problems in Europe: the Russian-Ukrainian crisis of 2006", *Asia-Pacific Review*, vol. 13, no. 2 (2006), pp. 32-59 and Pirani, Simon; Stern, Jonathan; Yafimava, Katja (2009): "The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment", Oxford Institute for Energy Studies (February 2009), at www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG27-TheRussoUkrainianGasDisputeofJanuary2009AComprehensiveAssessment-JonathanSternSimonPiraniKatjaYafimava-2009.pdf.

²⁰ This dispute will be studied in Chapter 7.

²¹ See: Yafimava, Katja (2009): "Belarus: The domestic gas market and relations with Russia", in Pirani, Simon (ed.): *Russia and CIS markets and their impact on Europe*, Oxford University Press, Oxford, pp. 133-169 and Yafimava, Katja: "The June 2010 Russian-Belarusian Gas Transit Dispute: a surprise that was to be expected", Oxford, Oxford Institute for Energy Studies, (2010), at www.oxfordenergy.org/pdfs/NG43.pdf.

²² Orttung, Robert W., Overland, Indra: "A limited toolbox: Explaining the constraints on Russia's foreign energy policy", *Journal of Eurasian Studies*, vol. 2, no. 1 (2011), pp. 74-85; The authors list 31 energy disputes between 2000 and 2010.

²³ For the gas cut-off by Russia to Georgia in 2006 and the energy disruptions that took place in 2008, see: Tokmasishvili, Micheil: "Georgia's Gas Sector", in Pirani, *op. cit.*, pp. 267-268.

collapse of the Soviet Union, assessments range between two extremes where Russia is seen either as an expanding power making use of its increasing confidence to challenge the status quo or as a challenged country itself responding to, rather than taking the offensive. Within this debate, this research aims at providing a contribution in this same direction through the case study of three energy disputes and searches to clarify whether Russia challenges itself or responds to challenges and that in the particular field of energy relations in the post-Soviet space. For this goal, I will focus on three gas disputes that pitted Russia against Ukraine in the period 2006-2009, including those mentioned in January 2006 and January 2009 and the other small dispute of March 2008. These three disputes offer an excellent ground to test Russian motivations at least mainly for three reasons:

In the first place, these three disputes are characterized by very different patterns of escalation. This raises the question of why these patterns of escalation differed from each other. One obvious answer would be that escalation in these three disputes was the result of different Russian decisions. If that was the case, these three disputes represent a very interesting occasion to consider how changing circumstances might account for different Russian decisions before and during the disputes.

In the second place, and this is probably the most important feature, they involve a dispute with a transit country, and could (and in two of the three cases, albeit in different degrees, did) affect third parties, namely end consumers of Russian gas. The presence of these end consumers is vital as a benchmark for testing Russian willingness to assume risks for the sake of achieving interests involved in the bilateral dispute. This risk attitude can tell us much about how Russia behaves in the face of its environment and could offer us some clues to assess whether Russia seeks to increase its power at the expense of its neighbors or whether it responds to what is perceived as diminishing power in the face of a hostile environment. Namely, whether we see an offensive or a defensive Russia.

In the third place, these three disputes involved gas and not oil and Ukraine instead of Belarus. These last two elements are important as the effect of gas cut-offs is more serious than that of oil cut-offs and because within the transit of Gazprom's gas from Russia to the rest of Europe, Ukraine held, as already stated above, a quasi-monopoly with figures accounting to up to 80% of transit flows during the period 2005-2009. This strengthens the reasons for choosing these three disputes as the most suitable for testing risk-willingness from the part of Russia, as it is in the dyad Russia-Ukraine and not so much Russia-Belarus where we would expect Russia to be more concerned about the effects that supply interruptions might cause on consumers of Gazprom's gas and to be thus trapped in a dilemma regarding existing risks once decisions are to be taken in the face of disputes with Ukraine. Such a situation

probably forced Russia to assess the stakes in each of the disputes and to consider whether risks were worth taking for the sake of prevailing on Ukraine. We will assume that in the three disputes analyzed, Gazprom and by extension, Russia, were facing this dilemma.

As for the dispute, mentioned above, of June-December 2014, it might seem reasonable to see it included in our case study. If anything distinguishes this dispute from any other before, is the fact of its formidable length thereof: half a year. However, the extreme duration of this dispute betrays an element that sets it clearly apart from their three predecessors under analysis here, namely, that no other actor apart from the dyad Russia-Ukraine was affected. This might explain why the dispute could so "comfortably" last for so long. Objective elements, which will not be the object of thorough assessment here, could explain this fact. Having occurred during months of low demand, Ukraine did not have to impose restrictions on consumption. Besides this, the fact that at the time, only around 50% of European natural gas consumption from Gazprom transited Ukraine, left much spare capacity in the pipeline system. This spare capacity enabled Ukraine to use it for supply its consumption through existing reserves and additional shipments contracted from Poland, Hungary and Slovakia. In any case, the undeniable fact that a similar pattern of disruption, as in previous disputes, did not occur, is in itself a reason enough for considering the same risks did not exist for Russia, and for excluding this dispute from our study.

1. 2. Theoretical Framework

The discussion in the preceding section points to the existing debate regarding deterrence and the studies on the phenomenon of escalation. As will be explained in further detail below, the set of moves and counter-moves that both Russia and Ukraine made in the three disputes fits quite well into the model of escalation that in the study of international relations has been mostly applied to the phenomenon of war. Using the model of escalation forces us to pay attention to the logic of deterrence which has been at the basis of the concept of escalation: deterrence models presuppose that credible deterrence should correlate with a lesser escalation. Following this logic in the current case we would assume that the greater the confidence displayed by Russia, the more necessary it should be on the part of either Ukraine as consumer or third countries depending on normal flows through Ukraine, to warn Russia of the possible consequences of decisions bringing upsets through gas cut-offs.²⁴ If we followed this logic, either there

²⁴ The obvious warning from Ukraine would be to escalate the dispute and affect third countries with the threat to impose reputational costs on Russia. As for these third countries, although more complex, warnings to Russia would take the form of imposing costs deriving from the loss of reputation caused by the dispute.

was a failure of deterrence in the extreme case of January 2009 or Russia's cost-benefit calculation made deterrence non-credible.²⁵ This would invite us to assume that risks deriving from using end-customers as "hostages" of a bilateral dispute were assessed as irrelevant or at least acceptable or that the other actors failed to signal their disposition to "punish" Russia for its actions,²⁶ leading to deterrence failure.²⁷ If the former was the case, either Russian valuation of its own power or the valuation of another actor's power changed, modifying the cost-benefit calculations in each of the disputes.²⁸ However, the debate cannot be closed at this stage without considering the larger debate and all contributions that led to the concept of spiral logic as well as those deriving from new findings in cognitive psychology that have been applied to the study of international relations as an explanation of this concept.²⁹ Taking into account this larger debate, we see the ground open to new hypotheses based on varying degrees of risk-acceptance. While most deterrence failures were traditionally assumed to be the result of a lack of information and derived miscalculations, the literature on spiral logic which pointed to deterrence as having opposed effects to those intended and the insights from prospect theory (as devised by Kahneman and Tversky and as seen

²⁵ In this case we could consider that Russia felt confident enough to assume the costs deriving from taking third countries "hostage" if necessary for the sake of prevailing on Ukraine and thus to dismiss possible consequences. Using expected utility which forms the basis of rational choice theory, this can take two forms: either Russia assumed there would be negligible consequences from these "hostages", be it in terms of a revision of their energy policies or relations in general with Russia (irrespective of whether Russia erred or not in its calculation of these consequences), or that independently of how it calculated consequences, it nevertheless assumed that costs deriving from not prevailing on Ukraine were higher than costs deriving from any kind of "reprisals" undertaken by "hostages" of the energy dispute. In either case, we would see Russia simply calculating costs and taking the most rational option.

²⁶ The concept of signaling is discussed in: Jervis, Robert (1970): *The logic of images in international relations*, Princeton, Princeton University Press; for the credibility of deterrence, see: Huth, Paul K. (1988): *Extended deterrence and the prevention of war*, New Haven, Yale University Press. Paul Huth, Christopher Gelpi and Scott D. Bennett (Huth, Paul; Gelpi, Christopher and Scott, Bennett D.: "System uncertainty, risk propensity, and international conflict among the great powers", *Journal of Conflict Resolution*, vol. 36 (1992), pp. 478-516 and Huth, Paul; Gelpi, Christopher and Bennett, D. Scott: "The escalation of great power militarized disputes: Testing rational deterrence theory and structural realism", *American Political Science Review*, vol. 87, no. 3 (1993), pp. 609-623) test deterrence theory against structural realism and conclude that uncertainty is solved once disputes are initiated. They also show that escalation processes unfold according to the former's expectations; once disputes are initiated, "signals" provide effective information.

²⁷ Deterrence failure by inappropriate signaling presents us with a certain puzzle with regard to the way information was processed by the Russian side: de-escalating in January 2006 fits the pattern described by Huth, Gelpi and Bennett (see fn. above), with signals being provided by Ukraine's counter-moves and Russia ending the dispute in consequence. It is not likely that Russia would have forgotten the lesson later in January 2009 and made "worse" mistakes further escalating that new dispute. We could accept deterrence failure for January 2006 as a reason for the dispute initiation, but not for January 2009, where information was already available and Russia nevertheless applied the "wrong" lesson. Most likely, there was a change in valuation of the cost-benefits.

²⁸ Deterrence, as applied in cases of disputes (potentially) leading to war, has no trouble in identifying the power attributes by different actors and the clear consequences of lesser or greater power. Applying the concept of power to the more complex and non-military based energy disputes where "weapons" consist of cutting off gas is more challenging: what can determine an increase in Russian "power"? Power is understood here as an objective element that increases the chances of prevailing in the dispute and arguably explains a greater or lesser willingness to use force; as force here is represented by the harming capacity of cutting off gas, which remains essentially the same, a graduation of power here seems difficult to be considered. However, "power" by actors who can impose costs (we consider further below what this "power" can be) on Russia if they negatively react to gas cut-offs (namely, if they blame Russia) can be simply measured by their willingness to impose these costs, irrespective of what inspires this willingness.

²⁹ See below in the theoretical framework for the discussion regarding these concepts.

below, used by several authors in the field of International Relations), raised new questions and arguably offered a more complex instrument to analyze escalation processes and the existence of disputes beyond what deterrence theory and the literature on miscalculation may have predicted. As will be further explained below, for the theoretical framework in this research I will distinguish the status quo as framed in gains, which makes actors be risk-averse, and the status quo as framed in losses, which on the contrary makes actors become risk-acceptant and likely to respond in ways that increase conflict. The financial stakes involved for Russia both when discussing pricing of its own gas and transferring costs of Central Asian gas price increases to Ukraine, are easily measurable and can provide us with a clear benchmark to consider Russian valuation of the status quo assuming Russia as a profit-maximizer, be it in strictly financial terms or in strategic gains through stakes in the energy sector of Ukraine. More complex is the political variable: during the whole period from 2005 to 2009, the presence of Yushchenko's Administration and the two Timoshenko governments, the first from January to September 2005 and the second from December 2007 to January 2010, are arguably factors that could explain why the two most virulent disputes ever between Russia and Ukraine (besides the small dispute of March 2008) took place during this period. Compared to the relatively harmonious relations in the energy field between Russia and Ukraine during the Administration of Kuchma and the short government by Viktor Yanukovich from October 2006 to December 2007, the period when Timoshenko was prime minister stands out indeed, as the three disputes happened during her period. If at least this could be an "obvious" explanation of why these disputes occurred, explaining the different escalation of the three disputes may be more challenging if politics were part thereof, as it is hard to somehow quantify it and to find a clear pattern of cause-effect. Non-economic issues become even more difficult once we consider the strategic context for Russia and think how this might have affected decisions taken in each of the three disputes. This becomes particularly obvious when we consider the most virulent dispute, that of January 2009, and realize that in April 2008 the NATO Summit took place in Bucharest (where Georgia and Ukraine were to be invited to forge closer relations with the organization and which Russia feared as a first step for their entry into the security organization) and in August of the same year Russia attacked Georgia.³⁰ We may face similar problems over the role played by internal Ukrainian politics, but we could reasonably expect that changes leading to either worsening of the strategic status quo or increasing Russian power would increase the

³⁰ Some of the accounts for this episode can be found in: Cornell, Svante E. and Starr, Frederick (eds.) (2009): *The guns of August 2008: Russia's war in Georgia*, Armonk, N.Y., M.E. Sharpe; Asmus, Ronald D. (2010): *A little war that shook the world: Georgia, Russia, and the future of the West*, New York, Palgrave Macmillan.

likelihood of disputes, which should be reflected in the patterns of escalation.³¹ Before reaching this stage though, it will be necessary to test whether the different escalation is either explained by Russia changing decisions or by Ukraine's lesser or greater resistance to Russian pressure, something which the empirical results from a detailed analysis of the negotiations in the energy field from 2005 to 2009 (the time frame when the three disputes took place) should help clarify. In a nutshell, **the goal of this research will be to find out why the pattern of escalation changed in these three disputes and how either changes in the valuation of the Russia-Ukraine bilateral status quo or changes of the valuation of risks, affected Russian decisions and eventually its responses in each of these disputes.**

The Model of Escalation and Deterrence Theory

Classical deterrence theory, developed theoretically with the onset of the Cold War, characterized by the tense bipolarity between the US and the USSR and most importantly, by nuclear Mutual Assured Destruction (MAD), has been (and still is) of utmost importance in the academic field of international relations. Authors like Herman Kahn, Thomas Schelling, Albert Wohlstetter, Oskar Morgenstern, William Kaufman and Glenn Snyder, can be counted as the most notable scholars responsible for the development of the concept.³² Whether as a structural deterrence model or decision-making deterrence model, which in fact shares the assumptions of the former and refines it,³³ the baseline is that of rational actors bent on maximizing power and choosing alternatives according to its highest payoff. This is aptly portrayed by the model of escalation and which has been at the heart of deterrence studies. The best explanation is arguably that provided by Kilgour and Zagare:

The reason for choosing this model is because the two authors add important improvements that contribute to solving the paradox of classical deterrence. In classical deterrence most of the authors are influenced by the dilemmas of nuclear weapons and Mutually Assured Destruction (MAD) and rely on incredible and arguably irrational threats to provide for a rational explanation of the phenomenon of deterrence. Along with this nuclear bias, their portrayal of actors as always being willing to maximize power and always having an interest in subverting the status quo, is modified by Kilgour and Zagare, who distinguish different actors according to their preferences. As we see in detail below, our two authors

³¹ As for an explanation of why both increasing Russian power and worsening status quo (which can be translated as an indirect weakening of Russia) may have similar effects of conflict escalation, see below the discussion regarding prospect theory.

³² The list is taken from: Zagare, Frank C. & Kilgour D. Mark (2000): *Perfect deterrence*, Cambridge, UK ; New York, NY : Cambridge University Press, p. 4.

³³ *Ibid.*, pp. 19-20; as authors themselves put it: "the prescriptions of decision-theoretical deterrence theory extend structural deterrence theory by considering the micro-level implications of international structure and the high costs of nuclear conflict (*Ibid.*, p. 24).

usually focus on actors who either prefer submitting rather than risking war, or actually are willing to go to war before submitting to a rival. Interestingly, they also mention the possibility that an actor may actually prefer war to the current status quo,³⁴ something which is posited by prospect theory (see next section).

Thus the model of escalation explained by Kilgour and Zagare³⁵ aptly portrays the relation between two states either close to engaging in a dispute, or already engaged therein. The model includes several nodes of decision where state A and state B have to either accept the status quo, or escalate the dispute in order to modify that status quo.³⁶ The whole game stops when a state either chooses not to escalate further or when escalation leads to a final stage, which in the model is presumed to be war. The concept of escalation, which has been mainly applied to armed conflicts, catches the power dynamics that underlined these three disputes. The model of escalation, as designed by professors Zagare and Kilgour, will be applied to these three energy disputes that pitted both Russia and Ukraine against each other. The model offers a good tool to describe the stages through which the three disputes evolved. In addition to that, Zagare and Kilgour's model depicts different actors according to which decision they take at each node of the dispute (either to escalate or to back down) and thus opens the door to many insights related to both the deterrence vs. spiral logic debate and the contributions from cognitive theories such as prospect theory that is explained below. The latter will be applied to understand Russia's decisions and its underlying reasons for assuming a lower or higher degree of risk-acceptance in each of the disputes.³⁷

³⁴ As put by Zagare and Kilgour: "A threat will be said to be capable, then, if and only if the threatened player prefers the Status Quo to Conflict; when this relationship is reversed, the threat will be said to lack capability" (Ibid., p. 82).

³⁵ Zagare & Kilgour, "Perfect Deterrence", *op. cit.*; Zagare, Frank. C. (1987): *The dynamics of deterrence*, Chicago, University of Chicago Press, and Zagare, Frank C. (2011): *The games of July: explaining the Great War*, Ann Arbor: University of Michigan Press.

³⁶ For the decision tree representation, see: Zagare, Frank C.: "The dynamics of escalation", *Information and Decision Technologies*, no. 16 (1990), p. 253.

³⁷ These two different actors are "soft" and "hard" actors. The deterrence model leaves open what determines the reasons for either two to belong to one typology or other. As the main difference between soft and hard actors is that while both are dissatisfied with the status quo, the former would back down from the challenge once counter-challenged by the opponent, the latter would still choose war instead of backing down. However, both actors prefer the status quo to war. As explained by Frank C. Zagare and Mark Kilgour (Zagare, Frank C. & Kilgour D. Mark: "Asymmetric deterrence", *International Studies Quarterly*, vol. 37, no. 1 (Mar., 1993), p. 5), the difference between the two kinds of challengers is that one (soft) prefers to capitulate instead of going to war, whereas the preferences are inverted for the latter (hard). This appears somewhat puzzling: as a hard defender prefers to face the challenge instead of acquiescing, such action should not add additional costs to the challenger, as the defender's efforts at deterring simply nullify the expected gains of the challenge; reverting to the status quo would be still preferable than war, unless for an actor preferring war to the status quo from the very beginning. If we add the variable of reputation, then we can understand that capitulating adds costs apart from nullifying expected gains (as Jack Levy asks: "does the first state frame a possible withdrawal of the threat (or failure to implement it) as a retreat **to** the old status quo or a retreat **from** the new status quo? the second frame is more likely to induce risk-seeking behavior and the escalation of the conflict"; see: Levy, Jack S.: "Prospect Theory and International Relations: Theoretical applications and analytical problems", *Political Psychology*, vol. 13, no. 2 (1992), p. 290); if these costs were added to the status quo once the challenger has capitulated, then we could consider an expected-utility calculation where the status quo simply becomes more costly than war.

In this respect, the model of perfect deterrence which the two authors devised in their homonymous book, is a welcome expansion from the more simplistic portray of actors bent on risk-competitions for blind power-maximization as in the initial models, mostly based on Mutual Assured Destruction (MAD) dilemmas. A closer look at the way the three disputes escalated can highlight this:

In January 2006 pricing disagreements regarding both Russian gas supplied as payment for transit fees and Turkmen gas imported through Russia, led Russia to impose a total cut-off of shipments to Ukraine. Ukraine responded by siphoning off gas exported to Central and Western Europe, thus provoking supply disruptions in very dependent Central European countries. Russia decided on 2nd January to restore supplies, which started to come back to normal levels the next day, while an agreement was finally reached in the early hours of 4th January. In March 2008, a new dispute occurred this time because of debt owed by Ukraine's energy state monopoly, Naftohaz, filtered through the complex web of intermediaries that had been established as a result of January 2006 agreements and which involved Central Asian gas supplied in late 2007, and Russian gas exceptionally supplied from the start of 2008 to make up for undersupply due to unusually cold weather in Central Asia. This time, Russia decided to progressively start cutting off supplies by 25% on the first day and another 25% the next day. Ukraine's response was to threaten to siphon gas off as in January 2006. Russia did not escalate beyond a partial cut-off of 50% of normal supplies and an agreement was reached a week later. Then finally in January 2009, a new pricing dispute after most of the previous weeks had been spent on a debt dispute, led Russia to cut gas off as in January 2006. The difference this time however, lay in the fact that Russia did not back down in the face of disruptions in Central and Western Europe provoked by new instances of Ukrainian siphoning of transit gas. In order to deny Ukraine an escape from the dispute, it decided to progressively cut the flows of gas transported to the rest of Europe, thus deepening the energy crisis that most dependent countries were suffering. An end of the dispute came only with the signing between Russia and Ukraine of a final agreement.

As for what the concept of escalation can offer in terms of explanatory power, we are unfortunately faced with the underdevelopment of the concept itself. We can quote in this sense Pr.

This does not seem to be usually modeled by Kilgour and Zagare's model, even if they do consider the possibility and mention prospect theory, which we consider below (see: Zagare & Kilgour, "Perfect Deterrence", *op. cit.*, pp. 82, fn. 24 and 83). However, even this suggestion is ultimately wanting, as however a status quo may be diminished by the reputational losses, it should be seen as arguably better than the option of war if the status quo remained the preferred action in comparison. In any case, if war is seen as risky enough as not to be an option preferred to a peaceful status quo, it is our intuition that prospect theory and the consideration of risk-acceptance would fit a hard challenger better than expected-utility. This is the reason for thinking that this dichotomy between soft and hard actors in fact opens the door to explanations based on cognitive theories.

Carlson when she states: "*the problem of escalation has been widely discussed,*³⁸ *but until recently there have been few attempts to develop a general theory aimed at generating testable hypotheses of escalation processes*".³⁹ In that respect, it must be highlighted that the academic debate revolves around two different logics underlying the inner mechanism of escalation, according to which we find opposing interpretations: the first one, based on the logic of deterrence, assumes an actor would escalate when not faced with resistance and would refrain from further escalating any conflict when faced with a credible one; as defined by Paul G. Lauren: "*deterrence attempts to persuade an opponent to refrain from initiating certain action, such as an armed attack, that is viewed as highly dangerous by making him fear the consequences of such behavior*".⁴⁰ To this definition, we can add that the (more or less explicit) way to deter is to convince the target of deterrence that the cost of its actions will exceed the expected benefits.⁴¹ As professors Lebow and Stein point out, this presupposes a rational cost-benefit calculus.⁴² Another interpretation, based on spiral logic, assumes that an actor may escalate when faced with resistance and refrain when not. In fact in the model of escalation by Kilgour and Zagare as portrayed in their latest works,⁴³ we can find an approach, which comes close in its most simplified form to what these two different logics tell.⁴⁴ The two authors portray two kinds of actors, a challenger dissatisfied with the status quo and a defender satisfied with the status quo, and classify them as soft or hard, having this set of priorities: (A) Hard State: prefers war to capitulation, (B) Soft State: prefers capitulation to war.⁴⁵ Interestingly, this classification could be expanded from its minimalistic conception to describe patterns where each actor is classified according to the response it would make at each of the nodes of decision.⁴⁶

In any case, the debate on logics of deterrence and spiral opened the door to questioning the model of expected utility, which was the basis for rational choice. Deterrence theory which Paul Huth defines as:

³⁸ See other works such as: Kahn, Herman (1965): *On escalation: metaphors and scenarios*, New York, Praeger; Schelling, Thomas C. (1960): *The strategy of conflict*, Cambridge, Harvard University Press; Schelling, Thomas (1966): *Arms and influence*, New Haven, Yale University Press; Holsti, Kalevi (1972): *International politics; a framework for analysis*, Englewood Cliffs, N.J., Prentice-Hall; Smoke, Richard (1977): *War: controlling escalation*, Cambridge, Harvard University Press; Brecher, Michael: "Crisis escalation: model and findings", *International Political Science Review*, vol. 17, no. 2 (1996), pp. 215-230.

³⁹ Carlson, Lisa J.: "A theory of escalation and international conflict", *The Journal of Conflict Resolution*, vol. 39, no. 3 (1995), pp. 511-512.

⁴⁰ quoted in Sperandei, Maria: "Bridging deterrence and compellence: an alternative approach to the study of coercive diplomacy", *International Studies Review*, vol. 8, no. 2 (2006), p. 264.

⁴¹ Lebow, Richard N. and Stein, Janice G.: "Beyond deterrence", *Journal of Social Issues*, vol. 43, no. 4 (1987), p. 6.

⁴² *Ibid.*, *Idem*.

⁴³ See mainly: Zagare & Kilgour, "Perfect deterrence", *op. cit.* and Zagare, "The games of July", *op. cit.*

⁴⁴ As was already mentioned in ftn. 34 and ftn. 37.

⁴⁵ Zagare & Kilgour "Asymmetric deterrence", *op. cit.*, p. 8.

⁴⁶ See: Carlson, Lisa J. & Dacey, Raymond: "Sequential decision analysis of the traditional deterrence game", *Peace Economics, Peace Science and Public Policy*, vol. 10, no. 3 (Fall 2004), pp. 1-14 and Simon, Michael W.: "The Rogue State Response to BMD: The Regional Context", *Defense and Security Analysis*, vol. 18, no. 3 (2002), pp. 271-292.

"the use of threats by one party to convince another party to refrain from initiating some course of action"⁴⁷ was precisely based on expected utility and is under whatever of its forms (direct-extended and immediate-general)⁴⁸ linked to the threat of using force to avert an attack. However, as Robert Jervis pointed out, there seems to be circumstances where deterrence fails and leads to situations where reprisals do not deter, but on the contrary, further fuel conflict. This opposite logic has been named by this author, as spiral logic.⁴⁹ Ned Lebow proceeded with another vector of critique, blaming psychological mechanisms for nullifying information.⁵⁰ This same author, together with Janice Stein, was thus among the first "revisionists" of deterrence and in their ground-breaking article "Beyond Deterrence", they expanded to point to what they called political, psychological and practical problems with the applicability of deterrence as an effective tool;⁵¹ among political reasons, they convincingly distinguish between "gains" and "need".⁵² Echoing the empirical critique already made by Robert Jervis regarding spiral logic, the two authors state that if effective in case of "gains", deterrence might backfire when challengers are pushed by need.⁵³ The authors go as far as to state that "need" seems to be a better predictor of challenge than "opportunity",⁵⁴ challenging deterrence theory directly.⁵⁵ The intuition that different dynamics exist was already present in Schelling's earlier insight that deterrence actually is more easily achieved than compellence since the latter is an offensive goal and thus liable to cause more resistance in the target,⁵⁶ go precisely in the same direction. Since then, an important literature developed

⁴⁷ Huth, Paul K: "Deterrence and international conflict: empirical findings and theoretical debates", *Annual Review of Political Science*, vol. 2, no. 1 (1999), p. 26.

⁴⁸ See: Morgan, Patrick M. (2003): *Deterrence now*, Cambridge, UK ; New York and Cambridge University Press.

⁴⁹ Jervis, Robert (1976): *Perception and misperception in international politics*, Princeton, New Jersey, Princeton University Press and Jervis, Robert: "Cooperation under the security dilemma", *World Politics*, vol. 30, no. 2 (Jan. 1978), pp. 167-214.

⁵⁰ Richard Ned Lebow strongly makes the case in: Lebow, Richard N. (1981): *Between peace and war: the nature of international crisis*, Baltimore, The Johns Hopkins University Press and his chapter "The deterrence deadlock: a way out of the dilemma?", in Jervis, Robert; Lebow N., Richard and Stein, Janice G. (1985): *Psychology and deterrence*, Baltimore, Md., Johns Hopkins University Press; for a critique, see: Orme, John: "Deterrence failures: a second look", *International Security*, vol. 11, no. 4 (1987), p. 97.

⁵¹ Lebow and Stein, "Beyond deterrence", *op. cit.*

⁵² *Ibid.*, p. 6.

⁵³ *Ibid.*, *Idem.*, p. 36, 40, 63-64; This distinction closely echoes the difference between perception in the domain of gains and a tendency to risk-aversion, and perception in the domain of losses and a tendency to risk-seeking, as was found by the advocates of prospect theory and as we see further below (This is mentioned by the two authors to support their distinction between opportunity and need; see: *Ibid.*, p. 64; they return to this in: Lebow, Richard N. and Stein, Janice G.: "Rational deterrence theory: I think, therefore I deter", *World Politics*, vol. 41, no. 2 (Jan. 1989), p. 208).

⁵⁴ Lebow and Stein, "Rational deterrence theory", *op. cit.*, p. 223.

⁵⁵ The problem nevertheless is compounded by the fact that whichever factor, "need" or "opportunity" may be more or less present, it is very hard to find out which is the case, so policies advised for each of them can backfire when wrongly applied (see: Lebow and Stein, "Beyond deterrence", *op. cit.*, pp. 52-53); as Robert Jervis puts it: "*both threats and conciliation can produce the very consequences they were designed to avoid*" (Jervis, Robert: "Rational deterrence: theory and evidence", *World Politics*, vol. 41, no. 2 (1989), p. 183.

⁵⁶ Schelling, "Arms and influence", *op. cit.*, pp. 69-91; as Jack Levy states: "*it is generally easier to deter an adversary from initiating an action she has not yet taken than to compel her to undo what she has already done or to undertake actions which she would prefer not to do*"; see also: Jervis: "Rational deterrence", *op. cit.*, p. 29.

on perception and cognitive biases that accounted for deterrence failures and which questioned the model of rational actor that was presupposed in international statesmen.⁵⁷ Robert Jervis' work on perceptions,⁵⁸ where he first presented the concept of spiral logic, was arguably the first general book devoted to misperceptions and cognitive biases applied to International Relations.

Prospect Theory

Challenging expected utility theory, prospect theory⁵⁹ opens the ground for a new understanding of the way states respond to the power changes in international relations and offers some explanations to account for situations where deterrence does not work.⁶⁰ As summed up by Jack Levy, prospect theory mainly posits the following three theses:⁶¹ actors evaluate outcomes not based on the net asset levels (objective reference as followed by the theory of decision of expected utility on which rational choice is based) but on a reference point (subjectively chosen)⁶², losses are overweighted as compared to gains,⁶³ and arguably the main insight, and one which opens more avenues for its application to the study of international relations: states tend to be risk-averse regarding gains,⁶⁴ and risk-accepting regarding losses.⁶⁵ That means states would not risk their status quo for prospective gains if they are quite satisfied

⁵⁷ For a list of some of these, see: Lebow and Stein, "Beyond deterrence", *op. cit.* pp. 165-166.

⁵⁸ Jervis, "Perception and misperception in international politics", *op. cit.*

⁵⁹ See the seminal work: Tversky, Amos and Kahneman, Daniel: "Prospect theory: an analysis of decision under risk", *Econometrica*, vol. 47, no. 2 (1979). Serious attempts to apply prospect theory in international relations theory can be found in: Jervis, N. Lebow and Stein, *op. cit.*; Stein, Janice Gross and Pauly, Louis W. (1993): *Choosing to co-operate: how states avoid loss*, Baltimore, Johns Hopkins University Press; Davis, James W. (2000): *Threats and promises*, Baltimore, Maryland, The Johns Hopkins University Press. and Taliaferro, Jeffrey W. (2004): *Balancing risks: great power intervention in the periphery*, Ithaca, New York, Cornell University Press.

⁶⁰ Deterrence failure has been may be blamed on miscalculations. See: Lebow and Stein: "Beyond deterrence", *op. cit.*

⁶¹ Levy, Jack: "An introduction to prospect theory", *Political Psychology*, vol. 13, no. 2 (1992), p. 171.

⁶² The reference point is normally the present position or status quo, but due to this subjective character, it can be some other point identified with a certain aspiration (Levy, "An Introduction to Prospect Theory", *op. cit.*, p. 174). The consequence of the relativity of the reference point is that whenever this point moves, the evaluation of prospects change (*Ibid.*, p. 181). Expected utility does not consider such changes if the net asset does not change (see: *Ibid.*, *Idem.*), whereas under prospect theory, this could remain equal but the actor behaves differently depending on the reference point chosen in the early phase called by Kahneman and Tversky as "editing" phase (see: Kahneman and Tversky, "Prospect theory", *op. cit.*).

⁶³ Expressed in the language of utility functions, this means that these are concave in the domain of gains and convex in the domain of losses (*Ibid.*, p. 174). This translates into risk-aversion in the domain of gains (concave) and risk-seeking in the domain of losses (convex) (*Ibid.*, p. 173), which contradicts the usual assumption in expected utility that risks are defined by a linear utility function (*Ibid.*, *Idem.*) and that actors are risk-neutral. This has also another related dimension, which is the general tendency of "loss-aversion" based on the "endowment effect" (*Ibid.*, p. 175), which can be summed up by the phenomenon of higher prices demanded for goods already possessed, compared to equivalent ones which are not. Another classical phenomenon found in economic behavior is the "trap" of "sunken costs", or to "throw good money after bad", which is nothing less than risking further financial resources to recoup losses suffered and which fits with risk-seeking in the domain of losses (Jervis, Robert: "Political implications of loss aversion", *Political Psychology*, vol. 13, no. 2 (1992), p. 188).

⁶⁴ As Robert Jervis points out, this finding is not novel, as this was already foreseen by expected utility theory, whereas risk-seeking in the domain of losses is what essentially contradicts tenets by expected utility theory (Jervis, "Political implications of loss aversion", *op. cit.*, p. 187).

⁶⁵ In the experiments carried out by Daniel Kahneman and Amos Tversky, risk-aversion in the face of gains and risk-seeking in the face of losses represented high percentages among participants, with percentages of 40% to 20% remaining risk-averse

with that status quo, while they would run risks to prevent losses if they consider their status quo to be unsatisfactory.⁶⁶ The complexity added by prospect theory as compared to expected utility becomes manifest when we consider how outcomes can change depending on how an actor frames a certain problem, as depending on whether a status quo is framed in the domain of gains or losses, we may expect that actor to assume different risk attitudes. The consequences these cognitive phenomena may have in the case of actors in the international arena is significant and can account for security dilemmas that fuel conflict: the endowment effect can lead an actor to undervalue concessions made by the adversary (seen as gains) and to overvalue those made to the adversary (seen as losses) and make settlements more difficult.⁶⁷ In a similar way, in line with insights by Schelling, who theorized that deterrence was easier than compellence,⁶⁸ and in accordance with the tendency to accommodate sooner to gains than to losses,⁶⁹ an actor trying to recoup losses, would face an actor treating its recent gains as part of his (new) status quo; this means that both actors would frame the situation in the domain of losses,⁷⁰ which would then foster risk-seeking and further conflict.⁷¹ This would increase the need to discover how a particular actor frames the status quo in order to know what are the measures advisable when dealing with its possible challenges to the status quo. If an actor acts aggressively in order to make gains, application of prospect theory in the field of International Relations would have us think that deterrence is the best response;⁷² actors behaving aggressively and challenging the status quo would be easily deterred if faced with credible power as they would not risk the status quo for any prospective gains. Instead, an actor behaving aggressively to avoid losses would only become more aggressive in the event of facing deterrence;⁷³ deterrence would confirm for that state that it is located in the domain of losses⁷⁴ and would thus

when faced with losses (Levy, "Prospect theory and international relations", *op. cit.*, p. 305). It is for this reason that it seems more appropriate to talk about tendencies rather than a constant pattern.

⁶⁶ See: Levy, "An introduction to prospect theory", *op. cit.*

⁶⁷ Levy, "Prospect theory and international relations", *op. cit.*, p. 290.

⁶⁸ Schelling, "The strategy of conflict", *op. cit.*

⁶⁹ Levy, "An introduction to prospect theory", *op. cit.*, p. 177.

⁷⁰ The first actor, because of non-accommodation to losses and the reference point of the previous status quo before the losses and the second actor, because of fast accommodation to recent gains and a reference point of the current status quo now threatened.

⁷¹ Jervis, "Political implications of loss aversion", *op. cit.*

⁷² As Robert Jervis remarks, "As Lebow & Stein (*"Beyond deterrence"*, *op. cit.*) note, deterrence theory is designed primarily, to explain how to deal with countries that are seeking gains, in these circumstances, deterrence may be effective..."; see, Jervis, "Political implications of loss aversion", *op. cit.*, p. 192).

⁷³ Following the same author, drawing from Lebow and Stein's insights: "But if the other is driven by the fear of losses, threats and coercion are likely to backfire, producing a spiral of greater hostility..."; see: Lebow & Stein, "Beyond deterrence", *op. cit.*, pp. 192-93. The point is also made in the same issue by Jack Levy: Levy, "Prospect theory and international relations", *op. cit.*, p. 289.

⁷⁴ As for the use of the Word "domain", we assume Taliaferro's critique, which deems that this word hints at some "objective" measurement and does not fit into an appreciation based on the actor's perception (Taliaferro, Jeffrey W.: "Power politics and the balance of risk: hypotheses on great power intervention in the periphery", vol. 25, no. 2 (2004), p. 192). We nevertheless keep using it, fully accepting the caveat for descriptive clarity.

reinforce the very motivations that compelled it to act that way. Deterrence would thus backfire. In such a case, appeasement would best be advisable, as yielding to certain demands would restore a status quo where the actor abandons its perception of being in the domain of losses and therefore feels satisfied with the new status quo.⁷⁵ Therefore, prospect theory offers the theoretical ground for understanding spiral logic and this in coherence with deterrence theory. Prospect theory's integration of spiral logic provides a much broader explanatory tool as it takes into account whether an actor perceives himself as located in the domain of gains or in the domain of losses and where failure by third actors either to deter or appease/accommodate fuels instability. As Lebow and Stein discussed, risk-prone gain maximizers (a "rare animal" according to prospect theory, as gain maximizers should tend to be risk-averse) are relatively uncommon in the international realm.⁷⁶

Prospect theory as it stands has been criticized in some respects. One of the questions is: how can it provide satisfactory explanations for intermediate cases? When do spiral logic reactions set in and turn deterrence into a self-defeating tool?⁷⁷ Stating that this depends on the reference framework taken by the actor, only tells half of the truth. If we take Kilgour and Zagare's game-tree representation, we can imagine a potentially never ending set of risk-averse to risk-accepting actors.⁷⁸ Are only actors willing to risk war risk-acceptant? Do all cases under this threshold therefore respond to deterrence theory? This seems to be a rather limited classification, the reason being that it does not account for crises short of war. Many authors have focused on cases where spiral logic implied a "substantial loss" or "precipitous decline"⁷⁹ and there seems indeed to be a certain bias to focus on either war situations or situations short

⁷⁵ This argument is further developed in the case studies by James W. Davis (see: Davis, *op. cit.*).

⁷⁶ Lebow and Stein, "Rational deterrence theory", *op. cit.*, p. 211.

⁷⁷ Carlson, Lisa J. and Dacey, Raymond: "Sequential analysis of deterrence games with a declining status quo", *Conflict Management and Peace Science*, vol. 23, no. 2 (2006), p. 182: In this article the authors consider the contradictory claims within the school of Prospect Theory, with some claiming a big loss to be necessary, and others claiming on the contrary that a simple negative loss will be sufficient.

⁷⁸ (As an example of a game with potentially never-ending nodes of decision, see: Powell, Robert: "Crisis bargaining, escalation and MAD", *The American Political Science Review*, vol. 81, no. 3 (Sep., 1987), p. 723) According to Mark L. Haas (see: Haas, Mark L: "Prospect theory and the Cuban Missile Crisis", *International Studies Quarterly*, vol. 45, no. 2 (Jun., 2001), pp. 250, 252), expected-utility theories often include different risk propensities between different actors (this may account for traditional classifications between soft and hard actors, as seen in works by Kilgour and Zagare), the main innovation by prospect theory in itself being that risk propensities vary in the same actor. Thus the expansion beyond a clear-cut differentiation between soft and hard actors to different degrees of "softness" or "hardness", or in prospect theory's language, risk acceptance and aversion, does not in itself derive from prospect theory. However, as prospect theory seems to have inherited the same reductionist dichotomy, this discussion becomes pertinent, specially bearing in mind that the focus here will be of an actor (Russia) that might have modified risk propensities assuming three different positions.

⁷⁹ See for example: Jervis, Robert: "Cooperation under the security dilemma", *World Politics*, vol. 30, no. 2 (Jan. 1978), pp. 167-214; Tessman, Brock. F. and Chan, Steve: "Power cycles, risk propensity, and great-power deterrence", *The Journal of Conflict Resolution*, vol. 48, no. 2 (2004), pp. 131-153 and Levi, Ariel S. and Whyte, Glen: "A cross-cultural exploration of the reference dependence of crucial group decisions under risk: Japan's 1941 decision for war", *Journal of Conflict Resolution*, vol. 41, no. 6 (1997), pp. 792-813; this classification is made by Carlson, and Dacey, "Sequential analysis of deterrence games", *op. cit.*, p. 182.

of war.⁸⁰ I assume however that within perceptions in the domain of losses there is a wide gradation. This is why I understand as intermediate those cases where an actor does perceive changes in its environment that pertain to interests guaranteed so far by the status quo, but henceforth endangered by an unfavorable change.⁸¹ If an actor under such circumstances is thus prompted to react to changes in the status quo, it may however counter-react to deterrence far short of escalating to the highest stage (war) when expectations are not met. In these cases deterrence may eventually work for preventing war. However, deterrence may initially fuel the crisis at earlier stages if deterrence replaces accommodation. These intermediate cases would fill the gap left between *suicide* spiral logic dynamics and *ideal* deterrence logic situations where terror precludes every move at the earliest stages. In fact, as far as this research is concerned, prospect theory, understood as encompassing these intermediate cases, seems to offer a more realistic framework to apply to our three disputes, where an inherent element of risk remains, due to the uncertainty as for the outcome of any eventual dispute. In fact, instead of prejudging a particular point beyond which we would define the actor under research, in this case, Russia, as a risk taker, being otherwise a risk avoider, and thus establish an unnecessarily artificial binary distinction, we consider that each case must be defined in relative terms, taking as a comparison the other cases under consideration. Thus for example, in the event that we discover that in the three cases variations respond exclusively to a worsening status quo and a constant valuation of the risk factor, we would define Russia in March 2008 as a more risk-averse actor than in January 2006, and at the same time define it as more risk-averse in the latter case than it would end up being in January 2009, thus avoiding a clear-cut but abstract and useless definition of Russia as either risk-acceptant or risk-averse.

A second question emerges, about which we have already introduced some lines above when mentioning the risk factor and which is closely related to this research. This second question regards the valuation not only of the status quo but of risks too, namely, the probabilities that either desired or undesired consequences of any action will ensue.⁸² As was noticed by Lisa J. Carlson and Raymond

⁸⁰ Jervis, Robert and Snyder, Jack L. (1991): *Dominoes and bandwagons: strategic beliefs and great power competition in the Eurasian rimland*, New York: Oxford University Press.; Jervis, Lebow & Stein, *op. cit.*; Jervis, "Prospect theory and international relations", *op. cit.*; Levi & Whyte, *op. cit.*; Davis, *op. cit.*; Haas, "Prospect theory and the Cuban Missile Crisis", *op. cit.* and Cha, Victor D.: "Hawk engagement and preventive defense on the Korean Peninsula", *International Security*, vol. 27, no. 1 (2002), pp. 40-78; this classification is made by Carlson, & Dacey (2006), *op. cit.*, p. 182.

⁸¹ In that respect, agreeing with Carlson and Dacey's classifications in their literature review, I will follow Mark Haas (Hass, *op. cit.*), and Jeffrey Berejikian (Berejikian, Jeffrey: "Revolutionary collective action and the agent-structure problem", *The American Political Science Review*, vol. 86, no. 3 (1992), pp. 647-657 and Berejikian, Jeffrey: "A cognitive theory of deterrence", *Journal of Peace Research*, vol. 39, no. 2 (2002), pp. 165-183) that "any negative valuation of the status quo is sufficient to induce risk-seeking behavior" (see: Carlson & Dacey, "Sequential analysis of deterrence games", *op. cit.*, p. 182).

⁸² Differences between prospect theory and expected utility theories become irrelevant once the risk factor simply fades. With actors being certain about the outcomes, there is no need to weigh the value of the status quo against the probabilities that yield the level of risk anymore. In the same way the strict dichotomy between risk acceptance and risk aversion has been criticized

Dacey, in most of the analyses of the existing literature of prospect theory applied to the study of international relations carried out so far, there is a general focus on the perception of the status quo, leaving out the consideration of other payoffs.⁸³ A closer look at Mark L. Haas' article "Prospect Theory and the Cuban Missile Crisis" may exemplify the need to look at both elements:⁸⁴ In the article, the author compared prospect theory with expected utility theory to find that when the situation was framed as in the domain of losses, both the US and the Soviet Union were risk takers.⁸⁵ Interestingly, whenever certainty prevailed, both countries would become more cautious even if their status quo had already worsened.⁸⁶ What becomes more relevant for the present research is what determined the switch from a situation of uncertainty where a status quo framed in the domain of losses fostered risks, to a new one of certainty which fostered cautiousness. In that case study, increasing risks that conflict would ensue, with the unbearable costs implied, was the determining factor that turned the Soviet Union into a cautious actor after having initiated the crisis assuming clear risks.⁸⁷ As the author explains, "*...individuals switch from risk-accepting to cautious behavior when either their domain changes or their probability estimates are in the ranges in which people are likely to overweight the impact of these estimates on their value calculation*".⁸⁸ The limitation of a strictly status-quo based framework as has been applied by most prospect theory studies on international studies becomes manifest once we take the case of Russian decisions in the three energy disputes. Russia need not have been influenced only by changes in the status quo, the payoff of either maintaining or challenging the status quo should be analyzed alongside the expected payoff of those (real or possible) consequences suffered by Russia after third countries reacted as a consequence of the dispute itself. The consequences for these countries lie at the heart of the dilemma that was explained at the start of this chapter and constitute what will be named henceforth the risk factor. The prospective reaction of European countries dependent on Russian gas transiting Ukraine was arguably a vital factor and should be taken into account along with those factors directly constituting the status quo in what we mentioned earlier as the valuation of risks. When we include this second payoff, we can then hypothesize another course of events, as instead of a changing status quo, we can imagine a

here, in this research there will be a focus on different degrees of risk, beyond a strict and equally reductionist delimitation of certainty and uncertainty. Arguably an unchanged status quo could nevertheless yield different "versions" of a same actor, if the probabilities are modified substantially, there being here a substantial change in probabilities and as a consequence, a different valuation of risks reflected in the escalation pattern. To this factor should be added changes in the valuation of risk in itself. Combined, these two factors should determine a global valuation of risk (risk would be determined by the probability of negative consequences and the value of these negative consequences). This can be perfectly integrated either into expected-utility theories or into prospect theory.

⁸³ Carlson, & Dacey, "Sequential analysis of deterrence games", *op. cit.*, p. 182.

⁸⁴ Haas, *op. cit.*

⁸⁵ *Ibid.*, pp. 242, 266.

⁸⁶ *Ibid.*, *Idem.*

⁸⁷ *Ibid.*, pp. 265-266.

⁸⁸ *Ibid.*, p. 252.

stable status quo but with a changing risk factor, be it because of a change in valuation of the consequences themselves, or in the probabilities for negative consequences to ensue as a result of the dispute. In this case, Russia's assertiveness could have been proportionally dependent on the degree of risk involved in cutting gas off to Ukraine as for the consequences for third countries dependent on Russian gas.

The two questions seen above are closely related to another third question, which has made prospect theory vulnerable to critics, even if we consider here this is not a flaw of the theory itself. The question is related to the critiques raised against the theory for not accounting for how actors choose their reference point and thus establish their baseline of expectations. Although this seems to have been mostly missed, this critique points to a much larger debate, which is that of constructivism and rationalism. Since Alexander Wendt, building upon previous contributions (mainly Hedley Bull from the English School)⁸⁹ introduced the concept of constructivism⁹⁰ in International Relations,⁹¹ many scholars have started along this new and promising path of research.⁹² The main point of contention of constructivism, as opposed to both neorealist and neoliberal rationalist mindsets is that interests, far from being given exogenously, are endogenously shaped by the actor's own construction of these interests. Thus the famous catch-phrase by Alexander Wendt, applied to the realist concept of anarchy in international relations, that "*anarchy is what states make of it*".⁹³ Even if current constructivist traditions remain far from having established a common school and are still divided over the debate of modernists and post-modernists,⁹⁴ the fact is that constructivism has established itself as the big third debate after (neo) realism and (neo) liberalism first

⁸⁹ Bull, Hedley (1995): *The anarchical society: a study of order in world politics*, Basingstoke, Macmillan.

⁹⁰ First coined by Nicholas Onuf (Onuf, Nicholas G. (1989): *World of our making: rules and rule in social theory and international relations*, Columbia, S.C.: University of South Carolina Press), but previously called reflectist by Robert Keohane (Keohane, Robert O. (1989): *International institutions and state power: essays in international relations theory*, Boulder, Westview Press.); see: Wendt, Alexander: "Anarchy is what states make of it: the social construction of power politics", *International Organization*, vol. 46, no. 2 (Fall 1992), pp. 391-425.

⁹¹ Wendt, Alexander: "The agent-structure problem in international relations theory", *International Organization*, vol. 41, no. 3 (Summer 1987), pp. 335-370; Wendt, "Anarchy is what states make of it", *op. cit.* and Wendt, Alexander (1999): *Social theory of international politics*, Cambridge, U.K.; New York, Cambridge University Press.

⁹² Kratochwil, Friedrich V. (1989): *Rules, norms, and decisions on the conditions of practical and legal reasoning in international relations and domestic affairs*, Cambridge; New York, Cambridge University Press; Onuf, *op. cit.*; Waever, Ole: "Security, the speech act: analyzing the politics of a word", Center for Peace and Conflict Research, Copenhagen, Working Paper no. 19 (1989); Katzenstein, Peter J. (ed.) (1996): *The culture of national security: norms and identity in world politics*, New York, Columbia University Press; Finnemore, Martha (1996): *National interests in international society*, Ithaca, N.Y., Cornell University Press.; Ruggie, John G. (1998): *Constructing the world polity: essays on international institutionalization*, London; New York, Routledge.

⁹³ Wendt, (1992), *op. cit.*, p. 395.

⁹⁴ As classified by Alexander (Wendt, "Anarchy is what states make of it", *op. cit.*, p. 393); Ted Hopf (Hopf, Ted: "The promise of constructivism in international relations theory", *International Security*, vol. 23, no. 1 (1998), p. 172), talks about conventional and critical constructivism, whereas Jeffrey Checkel (Checkel, Jeffrey T.: "The constructivist turn in international relations theory", *World Politics*, vol. 50, no. 2 (1998), p. 327) differentiates constructivism as such from standard IR theorists and postmodernists, portraying it as a middle ground, sharing the ontology of the latter and the epistemology of the former.

imposed themselves in the arena of IR Studies⁹⁵ and represents the main "challenger" of rationalism. Besides, many "constructivist" insights can arguably be traced back to important gaps left by realism⁹⁶ which have plagued neo-realism since its "(re)founding" by Kenneth Waltz. Waltz's own admission that foreign policies might differ from what international structure "dictates" and lead therefore to failures, beggars the question of why states do not behave as "rationally" expected. Stephen Walt's "Balance of Threat",⁹⁷ Randall Schweller's "Bandwagoning for Profit", his discussion on differences between status-quo defenders and revisionist powers and his "Theory of Underbalancing",⁹⁸ Gideon Rose's "Classical Realist"⁹⁹ formulation or Stephen Brooks' differentiation between "neo-realism and post-classical realism",¹⁰⁰ open the door to the role of ideas in states' formulation of their foreign policy. If realism has gone far down the path of abandoning a parsimonious structural theory such as that of Kenneth Waltz, whose descriptive power cannot explain different state's foreign policies, it seems that constructivism, in its epistemologically close conventional/non-critical form,¹⁰¹ could come to the rescue.¹⁰² Prospect theory offers a valuable alternative to expected value theory and adds to strictly rationalist theories contributions from the field of cognitive psychology. As the theory lacks a proper theory of framing, it could find a valuable ally in constructivism and its contributions to how interests and identities are built. In this respect, the concept of securitization seems to open up the most promising prospects:

One interesting example of constructivist contribution to the debate in IR Theory is the concept of securitization. This was coined by Ole Waever and Barry Buzan,¹⁰³ and linked to what has come to be

⁹⁵ See: Walt, Stephen M.: "International relations: one world, many theories", *Foreign Policy*, no. 110 (Spring, 1998), pp. 29-32+34-46, for a classification of different schools.

⁹⁶ For a constructivist reading of Hans Morgenthau, the father of realism in International Relations, see: Williams, Michael C.: "Why ideas matter in international relations: Hans Morgenthau, classical realism, and the moral construction of power politics", *International Organization*, vol. 58, no. 4 (2004), pp. 633-665.

⁹⁷ Walt, Stephen M. (1987): *The origins of alliances*, Ithaca: Cornell University Press.

⁹⁸ Schweller, Randall: "Bandwagoning for profit: bringing the revisionist state back in", *International Security*, vol. 19, no. 1 (1994), pp. 72-107; Schweller, Randall (1998): *Deadly imbalances: tripolarity and Hitler's strategy of world conquest*, New York, Columbia University Press; Schweller, Randall (2006): *Unanswered threats: political constraints on the balance of power*, Princeton, N.J.: Princeton University.

⁹⁹ Rose, Gideon: "Neoclassical realism and theories of foreign policy", *World Politics*, vol. 51, no. 1 (1998), pp. 144-172.

¹⁰⁰ Brooks, Stephen G.: "Dueling realisms", *International Organization*, vol. 51, no. 3 (1997), pp. 445-477.

¹⁰¹ Hopf, "The promise of constructivism", *op. cit.*

¹⁰² Barry Buzan and Ole Waever have come up with a very interesting theoretical formulation, "Regional Security Complex Theory" (see: Buzan, Barry & Waever, Ole (2003): *Regions and powers: the structure of international security*, Cambridge; New York, Cambridge University Press), where a realist framework is combined with lessons from constructivism; I would therefore agree with Michael Williams in that "Among the most prominent and influential of these new approaches is the theory of "securitization" developed by Barry Buzan, Ole Waever, and their collaborators, a body of work that has now come to be called the "Copenhagen School" (Williams, Michael C.: "Words, images, enemies: securitization and international politics", *International Studies Quarterly*, vol. 47, no. 4 (2003), p. 511).

¹⁰³ Waever, Ole: "Securitization and Desecuritization", in Lipschutz, Ronnie (1995): *On security*, New York, Columbia University Press.; Buzan, Barry, Waever, Ole and De Wilde, Jaap (1997): *Security: a new framework for analysis*, USA, Lynne Rienner Publishers.; Waever, Ole: "Securitizing sectors?: reply to Eriksson", *Cooperation and Conflict*, vol. 34 (1999), pp. 334-340 and Buzan & Waever, "Regions and Powers", *op. cit.*

known as the Copenhagen School,¹⁰⁴ security can be summed up as: "not an objective condition but an outcome of a specific social process".¹⁰⁵ Branding a speech-act as security (thus securitizing it) implies casting that issue as an "existential threat".¹⁰⁶ The concept of securitization provoked a barrage of criticism from different sides. Theorists from the side of critical constructivism have mostly highlighted the moral dilemma stemming from non-adverted normative consequences of the theory¹⁰⁷ and more generally rejected its "objectivism" accusing them of using non innocent categories.¹⁰⁸ Other critics, such as Holger Stritzel, are sceptical about the validity of the concept of "speech act" and propose its substitution by that of "translation",¹⁰⁹ whereas Thierry Balzacq rather tries to rebalance the stiff framework of "speech act", as understood by Ole Waever, putting more stress on the audiences of the securitization act, the context in which they are located and the power they grant the securitizing actor.¹¹⁰ One of the firmest defenders of the framework as put forward by the Copenhagen School, Rita Taureck, defends on the contrary its validity against normative critics.¹¹¹ Juha Vuori, from his side, expands the concept arguing that the kind of speech act explained by Waever is only one of a range of securitizing tools with different possible applications.¹¹² In any case, the debate around the concept of securitization seems to reproduce the broader lines of conventional and critical constructivism. The present work does not share the normative critic being leveled on the concept of securitization, believing on the contrary that its validity as an analytical tool deserves to be positively tested. Since the birth of this theoretical perspective, many pieces of practical research targeting securitization have focused on issues such as

¹⁰⁴ See article reviews by Huysmans, Jef: "Revisiting Copenhagen: or, on the creative development of a security studies agenda in Europe", *European Journal of International Relations*, vol. 4, no. 4 (1998), pp.479-505 and McSweeney, Bill: "Identity and security: Buzan and the Copenhagen school", *Review of International Studies*, vol. 22, no. 1 (1996), pp. 81-93.

¹⁰⁵ Williams, "Words, images, enemies", *op. cit.*, p. 513.

¹⁰⁶ *Ibid.*, p. 514; Waever in Lipschutz, *op. cit.*, p. 55.

¹⁰⁷ As Waever himself acknowledges: "One of the most common criticisms of this approach – the so-called "Copenhagen School", or the "speech-act" theory of security – is its political and ethical implications" (Waever, "Securitizing sectors?", *op. cit.*, p. 334).

¹⁰⁸ McSweeney, "Identity and security", *op. cit.*; McSweeney, Bill: "Durkheim and the Copenhagen School: A response to Buzan and Waever", *Review of International Studies*, vol. 24, no. 1 (Jan. 1998), p. 137-140; McSweeney, Bill (1999): *Security, identity, and interests: a sociology of international relations*, Cambridge, U.K.; New York, Cambridge University Press.; Huysmans, Jeff: "Defining social constructivism in security studies: the normative dilemma of writing security", *Alternatives*, vol. 27 (2002), pp. 41-62.; Aradau, Claudia: "Security and the Democratic Scene: Desecuritization and Emancipation", *Journal of International Relations and Development*, no. 7 (2004), pp. 388–413 and McDonald, Matt: "Securitization and the construction of security", *European Journal of International Relations*, vol. 14, no. 4 (2008), pp. 563-587.

¹⁰⁹ Stritzel, Holger: "Security, the translation", *Security Dialogue*, vol. 45, no. 4-5 (2011), pp. 343-355.

¹¹⁰ Balzacq, Thierry: "The three faces of securitization: political agency, audience and context", *European Journal of International Relations*, vol. 11, no. 2 (2005), pp. 171-201.

¹¹¹ Taureck, Rita: "Securitization theory and securitization studies", *Journal of International Relations and Development*, vol. 9, no. 1 (2006), pp. 53-61.

¹¹² Vuori, Juha: "Illocutionary Logic and strands of securitization: applying the theory of securitization to the study of non-democratic political orders", *European Journal of International Relations*, vol. 14, no. 1 (2008), pp. 65–99.

immigration¹¹³ and terrorism.¹¹⁴ Energy, another soft issue among security studies, is the focus in this research.¹¹⁵ However securitization will not be the focus here. The reason for mentioning securitization in this introduction is twofold and related to future avenues for research:

First, we see a parallelism between extreme dichotomies of risk accepting and risk averse countries, as has been common in prospect theory and the focus on "existential threats" in studies on securitization. Neither seems to have considered a broader understanding where intermediate categories exist. Even if this research does not deal with discourse, the positivistic focus on changes in escalation and its relation with changes in the status quo as well as the risk factor, opens the door to a discussion on securitization beyond discourse analysis. In fact, we might surmise that a discursive instead of positivistic focus of securitization and the search in discourse theory of whether something is securitized or not, has biased the debate towards absolute distinctions instead of more relative ones. Focusing on how an actor reacts to a changing environment could open the concept of securitization both to a positivistic assessment. Matching each of the decisions taken in a process of escalation to identifiable changes could enable an assessment of what Russia was securitizing and to what degree.¹¹⁶

Second, to what extent does constructivism in general and the novel understanding of securitization in particular, relate to the alleged shortcoming plaguing prospect theory? Regarding the incapacity of the theory to determine the point of reference due to its lack of a framing theory, there is on

¹¹³ Ayse, Ceyhan & Tsoukala, Anastassia: "The securitization of migration in western societies: ambivalent discourses and policies", *Alternatives*, vol. 27, pp. 21-39 (2002); Huysmans, Jeff (2006): *The politics of insecurity: fear, migration and asylum in the EU*, London; New York: Routledge.; Watson, Scott D. (2009): *The securitization of humanitarian migration*, London; New York, Routledge, Rens van Muster (2009): *Securitizing immigration: the politics of risk in the EU*, New York, Palgrave Macmillan., Pupcenoks, Juris (2010): *Muslim migrant impact on the European security agenda: lessons from Germany France and the UK*, Saarbrücken, Deutschland: VDM Verlag Dr Müller.

¹¹⁴ Nyers, Peter (2009): *Securitizations of citizenship*, London, Routledge and Debrix, François and Lacy, Mark J.(2009): *The geopolitics of American insecurity: terror, power and foreign policy*, London; New York, Routledge.

¹¹⁵ Pavel Baev uses the term securitization applied to energy but does not elaborate on it (see: Baev, Pavel (2008): *Russian energy policy and military power: Putin's quest for greatness*, New York, Routledge).

¹¹⁶ As we would consider here securitization in relative terms, namely, relative to a particular point of reference, each pattern of escalation could be at the same time an example of securitization and de-securitization. If the three disputes started with a decision by Gazprom to stop (fully or partially) the flow of gas to Ukraine as a result of disagreements on pricing and/or debt, it could be surmised from the start that there was a certain degree of securitization towards Ukraine in the three disputes. The matter however becomes more complicated when we focus on how each of these three disputes ended. The decision to stop in January 2006 when disruptions affected third countries and to stop in March 2008 before such disruptions may have occurred, we could say that Russia decided to de-securitize energy relations with Ukraine as an expression of securitization of Russia-Europe (here Europe understood in a very broad sense as encompassing all energy consumers of Russian gas dependent on normal transit through Ukraine). If securitization of relations with Ukraine implied a zero-sum understanding leading to conflict, in the case of securitization with European consumers, securitization should be understood as a positive sum, benefiting both Russia and its consumers, but in contradiction with the consequences of securitization of energy relations with Ukraine. As for the variation of both March 2008 and January 2009 in relation to the first precedent, January 2006, the question that could be answered in this research, insofar as it is possible, is whether that was a result of securitization of Russia-Ukraine relations, whether this went in the direction of a greater or lesser confidence from the side of Russia, or whether that was the result of lesser or higher securitization of Russia-Europe energy relations.

our part a strong disagreement with the critique that prospect theory is diminished by the absence of a framing theory imbedded within the general theory. The basis for this disagreement is that the task of providing tools to determine how framing takes place can perfectly be assumed by constructivism. We claim here that cognitive theories such as prospect theory and constructivism are fully complementary. We also clearly find fault with the critique focusing on framing theory rather than with the point of view assumed in this research project. The pretension of a general applicable framing theory for prospect theory is based on an objectivist assumption, whereas it seems obvious that the process of framing is subjective, an aspect which constitutes the backbone of constructivism and which justifies its complementarity with prospect theory.

1. 3. Research Design and main Hypothesis

This research will link the changing escalation of the three disputes of January 2006, March 2008 and January 2009 with changes in the status quo and the risk calculation based on the estimation of probabilities for each outcome. From the very beginning therefore, we will be facing a challenging task. Defining in a clear-cut fashion what is the value attributed to each of the payoffs involved in this research compounds one of the main challenges. As Jack Levy argues, referring to how easily controlled laboratory tests are carried out in contraposition to conditions prevailing in international relations: *"The utilities of the payoffs for each outcome are not given but instead are highly subjective"*,¹¹⁷ and as the same author again points out, application of prospect theory to the realm of international relations is compounded by the double difficulty of determining both the value of the payoffs and the existing probabilities.¹¹⁸

Regarding the status quo, the fact that we will be dealing with financial resources that can be objectively calculated should help in two ways: first, whenever we will need to define whether each of the three agreements that put an end to the energy disputes was advantageous or not for Russia, we can easily determine the exact economic gains for each of the two countries.¹¹⁹ This first step will at the same time offer the possibility to find out whether changes in the patterns of escalation in the three different disputes

¹¹⁷ Levy, "Prospect theory and international relations", *op. cit.*, p. 293.

¹¹⁸ *Ibid.*, *Idem.*

¹¹⁹ This is "easy" only in relative terms. The first obstacle is the opacity of the agreements reached in each case, as details are often secret and only obtainable through indirect means, mainly press reports. The second obstacle is to know whether Russia considered the losses in relative or absolute terms, namely was a "bad" agreement negative in terms of the financial costs, or was it considered positive if that agreement was better for Russia than for Ukraine? When we analyze the agreement reached after the January 2006 dispute, this will become more manifest.

were caused either by Russia or Ukraine. This is an extremely important task, as the goal of this research is to analyze Russia's decisions in the face of these disputes; if it was Ukraine's differing set of responses which could account for these changes, we could deduce that Russia maintained a constant policy. The analysis of the agreements reached is arguably the best way to determine this: if for example the three disputes ended with three agreements favoring Russia, then we would assume that Russia did not de-escalate until a series of demands was not fulfilled and that the different length and pattern of escalation responded to a lessened or heightened resistance from the part of Ukraine to accept these demands. Second, discussions previous to the disputes are a good way to know what were the financial objectives each of the two actors aimed at, as many figures are mentioned during lengthy negotiations that often last several months.¹²⁰ This seems to offer a reasonably well measurable standard.

Defining with the same ease which were other costs involved in each of the disputes that may account for the different decisions taken at each of the nodes of decision is more difficult. As economic issues are hardly insulated from political matters pertaining to bilateral relations between Russia and Ukraine and the position of the former in geopolitical terms in general, these latter elements also form part of the status quo. Matters of prestige involving Russia's standing among other powers and the political situation in the post-Soviet Space are difficult to trace. Even more difficult will be to link these issues to the energy disputes themselves. However, whenever the pricing discussions can reveal changing financial stakes from one dispute to another, we can, in the measure of possible, link these changes to whatever change in the pattern of escalation which took place. This can provide us with an objective valuation of the costs of the status quo in terms of negotiations between Russia and Ukraine and help us in what is arguably the main factor of what is termed here the status quo (on the preliminary consideration of economic issues as more relevant in this particular aspect, see next chapter and its literature review). In this respect, as for the valuation of the status quo in bilateral energy relations between Russia and Ukraine, one useful benchmark for linking variations in March 2008 and January 2009 to other variations that may be registered in the status quo should be the dispute of January 2006 itself, as it represents the first part of the whole "game" composed by the three disputes that will be analyzed. The reason for proceeding in this way is because this first "match" provides information that was not necessarily available before. Both Ukraine's and other European consumers' reactions could be guessed, but no empirical proof thereof was really available to date. Before the January 2006 dispute, a similar dispute had happened in 2004 between Russia and the other main transit country, Belarus. Whether the ease with

¹²⁰ A new obstacle will appear here, as for determining what were the optima of Russian interests, a necessary distortion stems from the consideration of each of the prices Russia demanded at some point to Ukraine for the gas supplied as either the real expected goal or a inflated price meant taking a position favorable in negotiations.

which the dispute was solved then and the shortness of gas cutoffs that affected third countries might have had a certain effect on Russian calculations, is worth considering. However, since the dilemma was arguably smaller then and bearing in mind that January 2006 is the first in a series of three disputes in the same dyad, we will not explore the influence the 2004 dispute with Belarus might have had. We will simply leave the question open as if it could have influenced January 2006 considering that Russia might have started the dispute confident that it could be solved in a similar way as it was two years before.

After the valuation of the status quo, the second part concerns the valuation of risks depending on the assessment of probabilities for each of the outcomes. Here, as opposed to the valuation of the agreements reached after the three disputes and the status quo previous to these agreements, we enter a much more difficult arena. There are no clearly measurable data to consider whether the risks involved in starting an energy dispute that might affect end-consumers was higher or lower in the background context of each of the disputes. The energy policy from the European Union is a complex one, as we will show in chapter 5, and has two different levels: one is the energy policy promoted by the European Commission and the different policies promoted by member states. In this respect, the European institutions tend to promote a set of policies opposed to Gazprom, as reflected in particular by the third energy package and its legislation against monopolies that affect particularly the Russian state monopoly. Russia thus prefers to maintain close relations at the bilateral level with a certain set of countries, where energy projects are highly favored. That said, there is a particular element in energy policy that although not easily measurable, has a positive expression which makes it arguably the best candidate for trying to link changes in the patterns of escalation to other changes that take place at the same time in the general context in which Russia is located: the construction of alternative pipelines from the Post-Soviet space to the consumer countries in Europe.

During the time span that will be analyzed in this research, three pipeline projects were being promoted: "Nabucco", "Nord Stream" and "South Stream". The interesting fact about these three projects is that they represented opposed interests. From one side, Nabucco intended to establish a direct connection between Central Asian producers to European consumers. From the other side, Nord Stream and South Stream intended to establish a direct connection with consumer countries in Europe bypassing "troublesome" transit countries such as Belarus and Ukraine. In a nutshell, these different projects, Nabucco on one side and the two "Streams" on the other, represented not only different projects but also opposed philosophies. Both fostered direct links between producers and consumers in avoidance of transit

countries,¹²¹ but at the same time singled out radically different countries as "troublesome": Nabucco saw the problem in Russia whereas Nord Stream and South Stream on the contrary saw trouble in transit countries such as Belarus and Ukraine; Nabucco implied that over-dependence from Russia had to be counter-balanced by searching for an outlet from Central Asia that would not be bought by Gazprom, whereas the two "Streams" implied that disruptions stemming from problems caused by transit countries could be solved if additional outlets were created for Gazprom's gas to be exported around them. What is most interesting is that tracking the progress of these three projects can provide us with the arguably best tool for judging from the Russian side what was the risk of unwanted consequences from the part of consumer countries as the result of gas cutoffs in the event of an energy dispute. In a very simplified way, we could surmise that good prospects for Nabucco and bad prospects for Nord and South Stream were a signal that the mood in Europe was not favorable to Russian discourse of blaming transit countries; it seems that the logical consequence would be a negative response for Russia. On the contrary, we could surmise that good prospects for Nord and South Stream and bad prospects for Nabucco were a signal that the mood in Europe was favorable to the Russian discourse of blaming transit countries.¹²² One additional, but no less important feature about using the prospects for pipeline construction as an indicator of the margin of maneuver available for Russia in the case of a dispute arising with Ukraine, is that no other initiative from the side of consumers is more directly linked to the problematic relationship between producers and transit countries. The reason for that is simply that support for whichever option is an explicit reception of whichever narrative on "troublesome" countries.

Thus the research design of this project will consist of a **dependent variable** which is the set of decisions that Russia took in response to Ukrainian policies, leading to the genesis and to the different patterns of escalation in the three energy disputes pitting both Russia and Ukraine against each other in

¹²¹ This of course has to be qualified: Nabucco could not avoid transit countries in Eastern Europe, but more importantly, it would substitute Russia (and Ukraine) as a transit country to Europe for Central Asian gas by Azerbaijan and Turkey. Thus the benefit of Nabucco lies in bypassing Russia and assuming that Russia is worse as a transit country than Azerbaijan and Turkey. Only Nord Stream and South Stream can arguably be considered as real "alternatives" as bypass pipelines, as both avoid extra-EU transit countries (namely, Ukraine) and connect EU-territory directly to Russia as producer.

¹²² Here we will not deal with two particular issues that seem to be inextricably linked to the general issue of what "signal" the (non)promotion of any of these three pipelines provided to Russia. The first one is whether the supposed expectations Russia had regarding the mood in Europe were accomplished or not, namely, whether Russia felt secure to escalate a dispute which might eventually affect consumers to see that the lesson learnt in Europe after the resolution, went contrary to those "signals" before. If good prospects for the two "Streams" or bad prospects for Nabucco before one of the disputes did not reinforce this tendency, or even worse, reinforced the opposite narrative, will not be dealt with here; whether Russia's expectations backfired is also somehow secondary regarding the priority in each of the disputes, which was to prevail in the gas dispute with Ukraine. In this respect, only two affected European consumers, January 2006 and January 2009, and both affected them not only differently in quantitative terms, but were also qualitatively different; in January 2009 Gazprom took the decision to impose a total gas embargo through Ukraine (as will be dealt with in detail in Chapter 8), something for which it should bear absolute responsibility.

January 2006, March 2008 and January 2009. The first **independent variable** is the value of the status quo preceding the three disputes, which we will deal with more extensively later in the literature review and analyze in detail in three separate chapters afterwards. Although economic and political factors have been mentioned above, most of the empirical part devoted to this variable will focus on the financial interests, as pricing mechanism must be dealt with in particular detail and because whatever political factors may have influenced the energy disputes, they were probably subordinated to the course of negotiations and are secondary to it regardless of their lesser or greater explanatory power. The second **independent variable** is the level of risk, or risk factor, measured by the policies by consumer countries in order to solve the dilemma of their dependence on the Russia/Ukraine supplier-transit relation and the way it might have influenced Russian perceptions of risk and thus translated into changes in the pattern of escalation of the three disputes.

The main hypothesis we will be working with in this research is that Russia's decisions to either escalate or deescalate in the three disputes were related to changes in the status quo of Russia-Ukraine relations, both in economic and political aspects and arguably to the risk factor too, regarding how bilateral disputes could eventually affect consumers in the rest of Europe.

1.4. Chapters Outline

Chapter 2 will be devoted to a literature review of how energy policy in Russia has been dealt with and how this same literature has considered the energy disputes that took place in the post-Soviet space between Russia and other consumer and mainly, transit countries. A short introduction in the chapter will deal with the fault lines that go through the general discussion on Russian foreign policy to trace later how they condition the debate on energy policy. The main importance of the literature review will be to see how different authors have dealt with the three energy disputes of January 2006, March 2008 and January 2009 which are the focus of this research. Apart from these three, energy disputes between Russia and Belarus will also be given special attention, due to the similarity between them and those that happened between Russia and Ukraine. A particular emphasis will be placed on whether the three energy disputes could be better explained by political or economic reasons, as this debate is of great relevance for the detailed analysis of them that will be undertaken in the first empirical part. Chapter 2 will close this first introductory part.

Chapter 3 will open the second part of this research and will be devoted to a description of the two energy sectors of Russia and Ukraine, the two countries at the center of this thesis. Starting with a small explanation of the origins of the energy sector when both countries were part of the Soviet Union, most of the chapter will be devoted to how the two energy sectors developed in their respective countries after the fall of the Soviet Union during the tumultuous decade of the 90s and how stabilization ensued in Russia in the next decade while Ukraine still remained in a state of disorganization and low state control. Chapter 4 will complement this chapter focusing on how energy relations between Russia and Ukraine developed after the fall of the Soviet Union. After a brief introduction on relations between the two countries in general, the chapter will describe the level of conflict existing between both countries and the frameworks of cooperation that were applied or were at least contrived. The chapter will span until the latest events in 2015. The last chapter of this second part of the book, chapter 5, will devote its attention to the other "leg" of the triangle formed by the complex relation between Russia, Ukraine as consumer country and consumer countries in Europe, most of them, members of the European Union: energy relations between Russia, the European Union and some of its more relevant member states. As done in chapter 3, the chapter will start with how energy relations between the former Soviet Union and consumer countries on both sides of the iron curtain developed in the rest of Europe first with oil and then gas and the general panorama of political relations between the European Union and its main powers. Energy relations will be studied, as in the previous chapter, only until 2005, when the historical series of the three energy disputes starts.

The third part of this research will constitute our first empirical study and will therefore, focus on the first independent variable: Chapter 6, chapter 7 and chapter 8 will each be devoted to the three energy disputes of January 2006, March 2008 and January 2009 respectively. The time frame for the three chapters will cover the four years from 2005 to early 2009. The reason for doing so is that the start of the energy dispute of January 2006 arguably covers most of the previous year. Determining when an energy dispute starts is difficult, as any previous issue left unsolved can be identified as a necessary cause of the dispute. Reducing the energy dispute to the immediate causes would deprive the reader of a real perspective of the matter under discussion and reduce it to a strict description of the stages of the dispute without providing enough information about the deep reasons for the dispute to have occurred. In the case of January 2006 the choice seems relatively easy, as 2005 brings a substantial change with the arrival of Yushchenko at the Ukrainian presidency and his proposing radical changes both in the country's foreign and energy policy which depart from the agreements of Summer 2004 favored by Gazprom. As for chapters 7 and 8, they will cover the period from early 2006 to early 2009. In this respect, chapter 7 will

close with the relatively uneventful dispute of March 2008, while a big part of it will deal with the equally calm years of 2006 (after the first dispute) and 2007. Much of what happens in these two years before 2008 is somehow disconnected from March 2008 as the two price negotiations for years 2007 and 2008 developed successfully and debt disputes were also solved satisfactorily. However, we consider that the whole period from 2005 to 2009 needed to be recounted for the sake of the reader's general understanding of the energy dynamics that often develop between Russia and Ukraine. Events between January 2006 and late 2007 (where some elements appear which have a more direct bearing on the next dispute) have thus a secondary importance to the disputes themselves but may arguably have a pedagogical importance for the reader who may thus gain a window to the general dynamics. For chronological coherence, this period seems to fit chapter 7 best. Separating it into an additional chapter does not seem appropriate as it nevertheless easily connects to the events of March 2008 due to the negotiating dynamics present. As for chapter 8, the short distance between March 2008 and January 2009 solves the dilemma of the temporary frame we may have encountered before. This first empirical part will be closed by chapter 9, which will sum up the first relevant findings in the previous chapters answering whether Ukraine or Russia won each of the three disputes.

The previous part will be complemented by a second empirical part which will be devoted not to the status quo as before, but to the risk factor from the part of Gazprom and Russia. Therefore, similar to chapters 6 to 8, the time frame will be 2006-2009, when the three disputes occurred and as already mentioned, the focus will be what I have considered to be the best indicator of the "European mood" towards Russia as a manifestation of the possible repercussions for Russia of prospective reactions by consumers indirectly affected. These indicators are three pipelines projects, Nabucco, of (simplifying) anti-Russian intent and the two others, South Stream and North Stream, of (simplifying again) pro-Russian intent.

This thesis will end with conclusions in chapter 11, where findings made in chapters 5-10 will be interpreted through the lenses of prospect theory and final remarks will close our research. chapter 11 will answer whether the differences in escalation between the three disputes respond exclusively to Ukrainian decisions, and if not, how did changing Russian decisions match a changing status quo and to what degree that changing status quo was determined only by economic factors or also political ones. Whereas the second empirical part is restricted to one single chapter (chapter 10), the first part will occupy as much as four chapters (chapters 6-9). This is justified by the complexity between energy negotiations and disputes between Russia and Ukraine: whereas explaining negotiations and the three disputes requires much space

to clarify both the complex dynamics and the interpretation of several points that remain obscure, tracing the development of the three bypass pipelines is arguably less time and space consuming.

Chapter 2: Literature Review

2. 1. Russian Foreign Policy

The traumatic collapse of the Soviet Union and the ensuing turmoil threw the foreign policy of the new Russian Federation into disarray. After an idealistic and botched attempt to set a pro-Western course, as advocated by Foreign Minister Andrei Kozyrev (From 1990 to 1996), several schools then started contending for influence with the goal of determining the new Russian foreign policy.¹ Labels such as pro-Western policy, Eurasianism, Nationalism, CIS focused Imperialism, Multipolarism, etc., have become common in the academic debate and have been classified along a spectrum identified by two extremes which could be roughly labeled as pro-Western and anti-Western. The general view is that after the confusing decade of the 90s, the arrival of Vladimir Putin to the Russian presidency brought a more coherent foreign policy.² Whether this represented a substantial change in itself or was on the contrary a solidification of a previous tendency is a matter for debate. Jeffrey Mankoff for example considered in 2009 that the Russian foreign policy had indeed been following a pattern dating back from the very beginnings of the Russian Federation.³ This seems correct, as the failure of the pro-Western turn of the early 90s set the ground for a more assertive Russian foreign policy. However, as Tsygankov has highlighted, Putin's policy has been one of "Great Power Pragmatism", which he managed to translate both into identity and success.⁴ Even if national assertiveness has been crucial for the new foreign policy course, cooperation with the West when necessary has been pursued. In any case it probably seems fair to consider Putin's rule (including the "interregnum" of Dmitry Medvedev's Presidency) as the "restoration" of Russia's stature in tune with national identity, as this is the way it is understood by large parts of both the Russian elite and society. The question that emerges then is to know if this internal "alliance", which as explained by Tsygankov consists of the so called "checkists" and oligarchs,⁵ may have remained constant, leaving the government a degree of autonomy to change course depending on the circumstances or whether it evolved on the contrary in response to a rebalancing of domestic constituencies in favor of

¹ See: Buszynski, Leszek (1996): *Russian foreign policy after the Cold War*, Westport, Conn: Praeger.; Lo, Bobo (2002): *Russian foreign policy in the post-Soviet era: reality, illusion, and mythmaking*, Houndmills, Basingstoke, Hampshire; New York: Palgrave Macmillan.; Tsygankov, Andrei' (2010): *Russia's foreign policy: change and continuity in national identity*, Lanham, Rowman & Littlefield Clunan, Anne L. (2009): *The social construction of Russia's resurgence: aspirations, identity, and security interests*, Baltimore: Johns Hopkins University Press.

² Lo, Bobo (2003): *Vladimir Putin and the evolution of Russian foreign policy*, Oxford, Blackwell.

³ Mankoff, Jeffrey (2009): *Russian foreign policy: the return of great power politics*, Lanham, Md.: Rowman & Littlefield.

⁴ Tsygankov, "Russia's foreign policy", *op. cit.*

⁵ Tsygankov, Andrei': "Vladimir Putin's vision of Russia as a normal great power", *Post-Soviet Affairs*, vol. 21, no. 2 (2005), pp. 139-140.

the *siloviki*.⁶ Some authors trace changes of Russian foreign policy during Putin's and Medvedev's Presidencies back to changes in the power configuration in Russia's foreign environment,⁷ whereas others highlight the changing authoritarian nature of Putin's system of government supported by high oil prices as evidence of its expansionist intentions.⁸ Hegemony in the CIS space, multipolar balancing acts against the US, and cooperative relations with both the US, European countries and non-Western countries, compound what Russian foreign policy is made of. In any case, whereas some authors see Russia as an expansionist and revisionist power, others either contend this or limit the scope of revisionism to the post-Soviet space. The main divide is reflected by the difference in responsibility attributed to Western powers in Russian behavior. Often it is not disagreements over the existence or not of Russian aggressive responses to the expansion of the Western liberal order into the post-soviet space which explain this difference, but rather a diverging assessment of these responses. Whereas a first school blames Russia for this opposition and terms her behavior as revisionist, a second school on the contrary blames "Western" expansionism (NATO enlargement or support to agendas of democratization) as strategic revisionism.

2. 2. Russian Energy Policy

When it comes to Russian energy policy we must first highlight the vital role it has as an element of Russian state power and diplomacy. The goals of national strengthening and increased diplomatic stature have been explicitly linked to energy. As Putin himself had defended in his later famous candidate dissertation: "*Russia's natural resources base will not only secure the country's **economic development**, but will also serve as the guarantor of the country's **international position***".⁹ This has been clearly reflected in the state's growing influence in the energy sector. As for its energy diplomacy, Russia has

⁶ Staun, Jorgen: "Siloviki versus liberal-technocrats: the fight for Russia and its foreign policy", Copenhagen: Danish Institute for International Studies, DIIS; Andrei Tsygankov does also suggest something similar, but stating that the middle course outlined by Putin would have become even more stable (Tsygankov, Andrei: "Russia's international assertiveness: what does it mean for the West?", *Problems of Post-Communism*, vol. 55, no. 2 (March/April 2008), pp. 45,48).

⁷ See: Tsygankov, Andrei: "Finding a civilisational idea: "West," Eurasia," and "Euro-East" in Russia's foreign policy", *Geopolitics*, vol. 12, no. 3 (2007), pp. 375-399; "Russia in the Post-Western World: The end of the normalization paradigm?", *Post-Soviet Affairs*, vol. 25, no. 4 (2009), pp. 347-369; Ambrosio, Thomas: "From balancer to ally? Russo-American relations in the wake of 11 September", *Contemporary Security Policy*, vol. 24, no. 2 (2003), pp. 1-28.; Andrei Tsygankov for example foresaw an anti-Western turn in case of changes in "Russia's international settings" (Tsygankov, "Vladimir Putin's vision of Russia", *op. cit.*, 250-51).

⁸ Bugajski, Janusz (2004): *Cold peace: Russia's new imperialism*, Westport, Conn.: Praeger; Washington, DC.: Published in cooperation with the Center for Strategic and International Studies; Bugajski, Janusz (2009): *Dismantling the West: Russia's Atlantic agenda*, Washington, D.C.: Potomac Books and Brzezinski, Zbigniew: "Putin's imperial designs are reminiscent of Stalin's", *New Perspectives Quarterly*, vol. 25, no. 4 (2008), pp. 50-52.

⁹ Olcott, Martha Brill: "The Energy dimension in Russian global strategy, Vladimir Putin and the geopolitics of oil", James E. Baker Institute, Baker Institute Energy Forum (2004), p. 17; further on this: Balzer, Harley: "The Putin thesis and Russian energy policy", *Post-Soviet Affairs*, vol. 21, no. 3 (2005), pp. 210-25.

always shown itself assertive in bilateral disputes, a pattern that can be traced back to the decade of the 90s. As several case studies of disputes between Russia and transit countries in its Near Abroad have suggested, energy has been used either as an economic or political coercive tool in its relations with Belarus and Ukraine.¹⁰ The general pattern we can see in the relation established between the contending parts in two dyads, Russia-Belarus and Russia-Ukraine, is one of confrontation. As for the reasons for these recurring episodes of confrontation, and as happens in general debates about Russian foreign policy, interpretations range from the thesis of "Russian political blackmailing"¹¹ to the opposite thesis of "economic reasons",¹² the latter usually taking a more favorable view of Russia's reasons for many of its (at least alleged) aggressive reactions. The two "schools" mentioned above¹³ and the different interpretations they provide for Russian foreign policy, translate into analyses of Russia's energy policy which provide equally differing answers, especially when it comes to particular energy disputes.

The Narrative of Russian Energy and Political Power

The first narrative portrays Russia as a strategy motivated actor: according to this narrative, Russia uses energy as a weapon of foreign policy. Several analysts lump together the domestic process of energy policy implementation with the government's and dependent companies' (either public or private) foreign

¹⁰ Regarding Russia's energy power and its relation to foreign policy interesting studies have been published: Perovic, Jeronim; Orttung, Robert W and Wenger, Andreas (eds.) (2009): *Russian energy power and foreign relations: implications for conflict and cooperation*, New York, Routledge; Baev, Pavel: "From west to south to north: Russia engages and challenges its neighbours", *International Journal*, vol. 63 (Spring 2008), pp. 291-305.; Goldman, Marshall (2008): *Petrostate: Putin, power, and the new Russia*, Oxford; New York: Oxford University Press.; Orban, Anita (2008): *Power, energy, and the new Russian imperialism*, Westport, Conn.: Praeger Security International and Balmaceda, Margarita; Rosner, Kevin (series ed.) (2006): *Oil, gas, transit pipelines and Russian foreign energy policy*, London, GMB Publishing Ltd; Regarding issues related to Russian bilateral relations with transit countries and their domestic energy sector, see: Yafimava, Katja (2011): *The transit dimension of EU energy security: Russian gas transit across Ukraine, Belarus, and Moldova*, Oxford; New York, Oxford University Press and Balmaceda, Margarita M. (2013): *Politics of energy dependency: Ukraine, Belarus and Lithuania between domestic oligarchs and Russian pressure*, Toronto; Buffalo; London, Toronto University Press; for Ukraine, Balmaceda, Margarita (2008): *Energy dependency, politics and corruption in the former Soviet Union: Russia's power, oligarchs' profits and Ukraine's missing energy policy, 1995-2006*, London; New York Routledge.; Pirani, Simon: "Ukraine's gas sector", Oxford Institute for Energy Studies (June 2007), at <http://www.oxfordenergy.org/pdfs/NG21.pdf>; for Belarus, Balmaceda, "Oil, gas, transit pipelines and Russian foreign energy policy", *op. cit.*. The two main bilateral gas crises pitting Russia versus Ukraine have been analyzed in the following works: Stern, Jonathan: "The Russian-Ukrainian gas crisis of January 2006", Oxford Institute for Energy Studies (16 January 2006), at <http://www.avim.org.tr/icerik/energy-gas.pdf> and Pirani, Simon; Stern, Jonathan; Yafimava, Katja (2009): "The Russo-Ukrainian gas dispute of January 2009: a comprehensive assessment", Oxford Institute for Energy Studies (February 2009), at www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG27-TheRussoUkrainianGasDisputeofJanuary2009AComprehensiveAssessment-JonathanSternSimonPiraniKatjaYafimava-2009.pdf.

¹¹ Commentaries from the Jamestown Foundation and Radio Free Europe/ Radio Liberty have conveyed on many occasions the thesis of the "Russian bully", without been fully clear whether Russian was just blackmailing Ukraine or "warning" other European countries.

¹² Some examples will be mentioned below.

¹³ For a classification of Russian motivation in her energy policy, see: Orttung, Robert W., Overland, Indra: "A limited toolbox: Explaining the constraints on Russia's foreign energy policy", *Journal of Eurasian Studies*, vol. 2, no. 1 (2011), pp. 75-76.

energy policy.¹⁴ They either state or at least hint at a correlation between market and rule of law-unfriendly policies carried out by Putin's government to bring the energy sector back into the state's sway with supposed expansionist and maximalist goals enabled by the use of energy in Russia's foreign policy.¹⁵ Among this group the emphasis is placed either on the imperialistic policy of Russia towards countries in the post-Soviet space or on the European countries in general (sometimes by extension, the influence on the US is also underlined). As an example, Zeyno Baran portrays Russia as playing a game of divide and rule as a tool to preclude European energy projects reaching their goal of conveying Central Asian energy supplies bypassing Russia.¹⁶ The author goes as far as to equate energy power with military power and hints at the political power Russia would be willing to exert through state-owned Gazprom.¹⁷ On the side of Russian energy policy in the CIS, Bertil Nygren sees it as a tool to reintegrate the Post-Soviet space under the aegis of the Russian Federation and the restoration (or consolidation) of a Russia-centered regional space.¹⁸ In other accounts the emphasis is put on the nefarious effect on Trans-Atlantic and intra-European solidarity that Russian energy deals with some European states may have.¹⁹ This is a fruitful line of research that can be found in several authors. One clear example is Vladimir Socor, who relies on NATO reports of alleged Russian political motivations in its attempts to create an OPEC style gas cartel and echoes again the possibility of energy being used to split the Euro-Atlantic community.²⁰ Janusz Bugajski,²¹ or Martin Walker stress the same divide and rule game, allegedly consciously intended to prevent a common European policy.²² Moving to specific energy disputes, there is also a large array of

¹⁴ Goldman, *op. cit.* and Lucas, Edward (2009): *The new cold war: Putin's Russia and the threat to the West*, New York, Palgrave Macmillan.

¹⁵ These accounts seem to follow the "Riga axioms" as opposed to the "Yalta axioms" (Yergin, Daniel (1978): *Shattered peace: the origins of the cold war and the national security state*, Boston: Houghton Mifflin Co.), namely they derive conclusions about Russian foreign policymaking from features of the regime (authoritarianism equals expansionism and imperialism) instead of assuming foreign policy based on appreciations of power (weaker Russia with restrained rather than aggressive foreign policy).

¹⁶ Baran, Zeyno: "EU energy security: time to end Russian leverage", *Washington Quarterly*, vol. 30, no. 4 (2007), pp. 131-144.

¹⁷ It is worth mentioning that Russian power is seen through a revisionist agenda: European energy cooperation with Russia is not seen as much as a guarantee of European submission to Russia, but rather as an obstacle to the expansion of an agenda of confrontation with Russia motivated by her appalling democratic record and the challenge the country represents to foreign policy in the Post-Soviet space.

¹⁸ Nygren, Bertil (2008): *The rebuilding of Greater Russia: Putin's foreign policy towards the CIS countries*, London; New York: Routledge and Nygren, Bertil: "Putin's use of natural gas to reintegrate the CIS region", *Problems of Post-Communism*, vol. 55, no. 4 (July-August 2008), pp. 4, 13.

¹⁹ Smith, Keith C.: "Bringing energy security to East Central Europe", CSIS (April 2010), at http://csis.org/files/publication/100402_Smith_BringingEnergySecurity_Web.pdf; it must be pointed out that the author seems to refer mostly to the indirect effect on this solidarity and not so much on intentionality from the part of Russia.

²⁰ Socor, Vladimir: "Gazprom, the Prospects of a Gas Cartel, and Europe's Energy Security", in Cornell, Svante E. and Nilsson, Niklas (eds.) (2008): "Europe's energy security: Gazprom's dominance and Caspian supply alternatives", *Central Asia – Caucasus Studies, Silk Road Studies Program*, Johns Hopkins University-SAIS, p. 72, 83.

²¹ Bugajski, "Dismantling the West", *op. cit.*

²² Walker, Martin: "Russia v. Europe: the energy wars", *World Policy Journal*, vol. 24, no. 1 (2007), p. 4; It is not clear whether the main goal is strictly economic or political.

analyses in a similar line, as is the case with Evert Faber Van der Meulen, who takes for granted the political aspects of energy disputes with Georgia, Belarus and Ukraine.²³ Something similar can be found in Richard E. Ericson, who gives as an example of political use of energy the gas dispute of January 2006 between Russia and Ukraine,²⁴ and portrays Putin's Russia as having turned energy into a weapon since 2004 as a tool for integrating the CIS space.²⁵ Chloë Bruce on the contrary is a representative of a more nuanced vision of the narrative of politicization: while showing some instances of politicization of energy issues between Russia and Belarus in the 90s, as when Russia, in April 1994, offered subsidized prices in exchange for not being charged for the stationing of her troops on Belarusian territory, she avoids labeling Russian energy policy as a tool of imperialism.²⁶

The Narrative of Russian Energy and the Economic Dimension

Turning to the second narrative, which portrays Russia as an actor mostly motivated by economic reasons,²⁷ we may start with one of the most global accounts of Russian energy policy in the last decade, Orttung and Overland. The two authors account for a variety of motivations,²⁸ including political ones, but do point to the decision to turn to market prices in the whole Post-Soviet space as a general turning point. This is a fact equally stressed by Tsygankov,²⁹ who rejects the strategy motivated arguments and points to economic reasons, vital for Putin's regime to maintain Russia's standing as a Great Power. Here, the role of politics is subsumed in economic motivations and seen as a secondary factor. As it is assessed by Simon Pirani when dealing with Ukraine,³⁰ economic reasons have held the upper hand even if political considerations may

²³ Van der Meulen, Evert Faber: "Gas supply and EU–Russia relations", *Europe-Asia Studies*, vol. 61, no. 5 (2009), pp. 849-50.

²⁴ Ericson, Richard E.: "Eurasian natural gas pipelines: the political economy of network interdependence", *Eurasia Geography and Economics*, vol. 50, no. 1 (Jan-Feb 2009), p. 33, fn. 8.

²⁵ *Ibid.* pp. 39-40; The author however does not analyze why both the specific example of January 2006 and the general trend after 2004 respond to political reasons, and if they do, to what degree of relation to economic reasons in each of the cases. In fact, if any change may be perceived, it should be rather a move from strictly political pricing policy as was inherited from the Soviet Union, with CIS countries enjoying subsidized domestic prices.

²⁶ Bruce, Chloë: "Fraternal friction or fraternal fiction? the gas factor in Russian-Belarusian relations", Oxford, Oxford University Press (March 2005), at www.oxfordenergy.org/pdfs/NG8.pdf, p. 8; As the author further shows, a similar agreement happened again in 1996 (*Ibid.*, 9). Still, one of the main factors in this policy towards Belarus was the prospect of constructing the Yamal-Europe pipeline as an alternative to Ukraine's huge leverage as transit country at the time (90% of supplies to Europe). After de-politicization from 97-98, energy relations went back under Primakov to previous patterns, so Belarus started receiving favorable price arrangements again (*Ibid.*, 13-14).

²⁷ For a useful "prehistory" of the balance of politics and economics, where a vision of the latter's prevalence becomes manifest, see: Högselius, Per (2013): *Red gas: Russia and the origins of European energy dependence*, New York, Palgrave MacMillan. This book mostly deals with the Soviet Union.

²⁸ Orttung and Overland, *op. cit.*

²⁹ Tsygankov, Andrei: "If not by tanks, then by banks? The role of soft power in Putin's foreign policy", *Europe-Asia Studies*, vol. 58, no. 7 (2006), pp. 1079-1099.

³⁰ Pirani: "Ukraine: a gas dependent state", in Pirani et al., *op. cit.* We can also recommend the author's contribution "Russo-Ukrainian Gas Wars and the Call on Transit Governance", in Kuzemko, Caroline; Belyi, Andrei V.; Goldthau, Andreas and Keating, Michael F. (2012): *Dynamics of energy governance in Europe and Russia*, Basingstoke; England, Palgrave-Macmillan, pp. 169-186.

have had an impact on the timetable to move to market prices: CIS countries with whom Russia enjoyed good relations have been granted a more progressive timetable, whereas other countries, which like Ukraine, decided to move closer to the West, have been confronted with sharper demands. In fact, in 2005 Putin seems to have made explicit the political link between Russia and Belarus when he stated that in regard to energy prices, Belarus, as a partner in a project of political integration, was different.³¹ However, even these political motivations have to compete with more economic reasons when we take into consideration the usual Russian policy of gaining ownership of key assets in exchange for an advantageous pricing policy or debt condoning. The best example is probably Belarus: this country has managed to enjoy much better relations with Russia than Ukraine both under Yushchenko and under Yanukovich since 2010, but it also yielded 50 % of Beltransgaz's pipeline ownership to Gazprom to postpone the transition to market prices and eventually yielded the rest of its shares to the Russian monopoly to be ensured Russian domestic prices. Moves in the same direction in Ukraine have failed to date due to the resistance from Ukraine to yield strategic assets, even if there are also instances of "political" discounts: a new gas agreement was signed between Russia and Ukraine in April 2010, with the latter being "granted" a 30% discount in exchange for the extension of the Black Sea fleet lease up to 2042.³² Then on the 17th December 2013, Russia offered what looked like an explicitly political discount of 33% (bringing prices to US\$268tcm from around US\$385tcm), which lasted until April 2014.³³ The latest examples given for Ukraine as well as Russian tolerance for deviation from the agreed contract with Belarus in 2009,³⁴ are clear examples of politicization, but whether asset ownership is only a trade-off between economic interests and political interests is not fully clear, as it could be as much a guarantee of political control as a guarantee of economic predictability in the face of troublesome transit countries.³⁵ In other cases politics have also

³¹ Balmaceda, "Oil, gas, transit pipelines and Russian foreign energy policy", *op. cit.*, pp. 12-13; Instead of seeing an energy policy towards the post-Soviet space clearly motivated by geostrategy, we can follow Balmaceda when suggesting that the case of Belarus is an exception of politics-based energy relations in an age of pro-Western revolutions, as both in Georgia and Ukraine in 2003 and 2004 (*Ibid.*, p. 13). Rather than being the example of what would be the pattern of policy towards allies in the post-Soviet space, Belarus would be thus an exception based on the defensive position of Russia.

³² Pirani, Simon; Stern, Jonathan and Yafimava, Katja: "The April 2010 Russo-Ukrainian gas agreement and its implications for Europe", Oxford Institute for Energy Studies (June 2010), at <http://www.oxfordenergy.org/pdfs/NG42.pdf>.

³³ This discount seemed to be a clear "reward" for not having signed the Association Agreement (AA) with the EU in the Vilnius Summit of November 2013. The AA was eventually signed by the new authorities after Yanukovich's ousting in February 2014, its political part in March 21, and the economic part in June 27. As for the discount, as already mentioned, it ceased after the first trimester (from April 2014). New prices were temporarily agreed after gas supplies from Russia remained cut-off from the 16th June to early December 2014. This latest gas cut-off will not be analyzed in this work.

³⁴ Tolerance which, as seen later, seems to have faded by 2010, possibly for political reasons too (see: Yafimava, Katja: "The June 2010 Russian-Belarusian gas transit dispute: a surprise that was to be expected", Oxford Institute for Energy Studies, (2010), p. 14, at www.oxfordenergy.org/pdfs/NG43.pdf).

³⁵ Underlining the difference between using gas and oil as a foreign policy tool and simply lending political support for energy policy, Pavel Baev clearly supports this second version as reflecting Russian motivations (Baev, "From West to South to

been a supporting factor, as has been the case with the international expansion of oil and gas companies.³⁶ However, the political factor here was not the main driver; it was rather subordinated to economic interests. This is the direction taken by Anita Orban's analysis of the period of the 90s to the early 00s decade, where she highlights how economic expansion by energy companies into Europe is actively supported by the government.³⁷

The Narrative of EU-Russia Interdependence

In the literature on Russian energy policy, other authors prefer to focus on interdependence as the most distinctive feature of Russia-Europe energy relations. This is closely related to the former narrative, which highlights the economic dimension, and this for two reasons: first, Russia as an energy supplier is necessarily dependent on demand. Thus, a thorough assessment must necessarily take into account this other (strictly economic) side of energy relations to determine Russia's real position of power; second, whatever political dimension that may be derived from this reality is most probably determined by the margin left by the existing pattern of interdependence. Thus, if authors highlighting the Russian threat mainly underline European dependence (see above), Russian dependence on Europe is often an overlooked reality. Taking into account this other side of the coin yields a general picture of interdependency.

This interdependency is in essence ambivalent: it can be seen as the basis for strengthened and beneficial cooperation, but if undue mistrust is not avoided, this may eventually harm both actors, pushing them to a rush for diversification in attempts to escape (real or imagined) entrapment.³⁸ In this respect, Richard E. Ericson highlights the mutual dependence of both Russia and its European customers,³⁹ and acknowledges the potential both for monopoly and for monopsony.⁴⁰ Andrew Monaghan focuses on the fact that the energy weapon becomes ineffective and difficult to use for blackmailing purposes in such a context and then concludes that Russia is actually more dependent on Europe as supplier than the other way round.⁴¹ This is something that Jaffe and Soligo also state highlighting the damaging effect this would have

North", *op. cit.*, p. 295) and sees Russia just unwilling to suffer an excessive leverage by transit countries such as Belarus and Ukraine (*Ibid.*, p. 299).

³⁶ Poussenkova, Nina: "The global expansion of Russia's energy giants", *Journal of International Affairs*, vol. 63, no. 2, (2010), p. 121.

³⁷ Orban, *op. cit.*

³⁸ Orttung & Perovic, *op. cit.*, pp. 6-7.

³⁹ Ericson, *op. cit.*, p. 35.

⁴⁰ *Ibid.*, p. 37. In the case of natural gas being shipped to Europe from the FSU, relations, as already seen in the previous chapter, are particularly complex: there are situations of transit monopoly, as it is the case of Belarus and Ukraine with Russia, but with the latter being in a similar position in relation to other energy producers as Kazakhstan, Uzbekistan and Turkmenistan; Russia wielded her position as monopsonist until outlets were opened to both Iran and China.

⁴¹ Monaghan, Andrew: "Russia-EU: an emerging energy security dilemma", *Carnegie Endowment for Peace, Pro et Contra*, vol. 10, no. 2-3 (Summer 2006), at

for Russia given its state of dependence on European customers.⁴² In close relation to this reasoning, we may consider Anke Schmidt-Felzmann's explanation of the diverse measures taken by individual European countries in January 2009; this leads her to conclude that most countries could have withheld (even at high financial costs) some more weeks,⁴³ limiting therefore the real impact of the "energy weapon".

An "asymmetric interdependence" in favor of the European side is also highlighted by Elena Kropatcheva and Roland Götz.⁴⁴ Friedemann Müller takes another perspective and states on the contrary that in spite of the apparent asymmetric interdependence in favor of Europe, asymmetry favors Russia. Her explanation is that the latter would be readier to temporarily forego financial gains from exports than the former to stand protracted cut-offs.⁴⁵ This fits with the argumentative line followed by Richard E. Ericson of "asymmetric interdependence" between those dependent on immediate costs (consumers facing cut-offs) and those dependent on long term costs (suppliers stopping shipments).⁴⁶ Monaghan who rejects such assessment, coins the term of "energy dilemma" (later reflected, as seen above, by Orttung and Perovic),⁴⁷ to make the case that the real danger in mutual relations lies not in dependence but in the possibility of Europe unnecessarily pushing for diversification away from Russia against a non-existent danger of dependence, for this might trigger Russian diversification away from Europe.⁴⁸ Monaghan further adds that the fear of Russian use of energy as a weapon and the possibility of seeing the taps turned off is derived from an extrapolation of Russia's relations with Post-Soviet neighbors.⁴⁹ In fact, if any, the "threat" stemming from Russia according to Andreas Goldthau, would stem not from a non-existent Russian leverage at the service of geopolitical interests but from a lack of supply due to structural deficiencies

<http://www.carnegieendowment.org/files/EmergingDilemma1.pdf>, pp. 4-5.

⁴² Jaffe and Soligo, *op. cit.*, p. 35.

⁴³ Schmidt-Felzmann, Anke: "EU member states' energy relations with Russia: conflicting approaches to securing natural gas supplies", *Geopolitics*, vol. 16, no. 3 (2011), pp. 578-579.

⁴⁴ Kropatcheva, Elena: "Playing both ends against the middle: Russia's geopolitical energy games with the EU and Ukraine", *Geopolitics*, vol. 16, no. 3 (2011), p. 556 and Götz, Roland: "Russlands Erdgas und Europas Energiesicherheit", Stiftung Wissenschaft und Politik - Deutsches Institut für Internationale Politik und Sicherheit, SWP-Studie (August 2007), p. 22, at http://www.swp-berlin.org/fileadmin/contents/products/studien/2007_S21_gtz_ks.pdf.

⁴⁵ Friedemann, Müller: "Energieaussenpolitik: Anforderungen veränderter Weltmarktkonstellationen an die internationale Politik", Stiftung Wissenschaft und Politik-Deutsches Institut für Internationale Politik und Sicherheit, SWP-Studie (November 2006), at

http://www.swp-berlin.org/fileadmin/contents/products/studien/2006_S33_mlr_ks.pdf.

⁴⁶ Ericson, *op. cit.*, p. 39

⁴⁷ Perovic, Jeronim & Orttung, Robert: "Russia's energy policy: should Europe worry?", in "Russia's Energy Policy", *Russian Analytical Digest*, no. 18 (3 April 2007), at

<http://www.isn.ethz.ch/isn/Digital-Library/Publications/Detail/?ots591=0c54e3b3-1e9c-be1e-2c24-a6a8c7060233&lng=en&id=29825>.

⁴⁸ Monaghan, "Russia-EU", *op. cit.*, p. 6; Jaffe and Soligo see this as not very credible (see: Jaffe, Amy Myers and Soligo, Ronald: " Militarization of energy: geopolitical threats to the global energy system", James A. Baker III Institute for Public Policy, Rice University, Working Paper: *The Global Energy Market: Comprehensive Strategies to Meet Geopolitical and Financial Risks* (May 2008), pp. 36-37, at

<http://www.bakerinstitute.org/publications/IEEJMilitarization.pdf>.

⁴⁹ Monaghan, Andrew: "Russian oil and EU energy security", Conflict Studies Research Centre (November 2005).

caused by under-investment in the Russian energy market and by perverse incentives in the domestic market where prices remain subsidized.⁵⁰

In any case, whatever particular aspect is highlighted at the expense of the other, there seems to be a clear tendency for most of the authors to turn around the argument of dependence on Russian energy supplies and substitute it by the picture of interdependence, often pointing to outright Russian dependence on Europe and vulnerability to transit countries.

The Narrative of Russia-Transit Countries' Interdependence

The short discussion above highlights the fact that energy security, far from being only applicable to consumers, must also take into account producers' need.⁵¹ In this sense, as for producers' energy security, we should consider their dependence on transit countries. This is particularly manifest in the case of Russia as highlighted by Elena Kropatcheva.⁵² Ericson also points to transit countries who *"have the capability to block trans-shipment and to 'siphon off' natural gas for their own use if there is a shortage";⁵³ "Ukraine and Belarus have some leverage over Russia, and indeed Europe, through their ability to independently disrupt Russian natural gas supply to Europe".⁵⁴*

In this respect, the latest book by Margarita Balmaceda,⁵⁵ analyzes the reality of interdependency between Russia, who supplies energy to three states under analysis: Ukraine, Belarus and Lithuania, while it is dependent on these states due to their condition of transit countries. The three countries are used as case studies to analyze in what measure they reduced their dependence on Russia, and what can explain their success or lack thereof. What is interesting for our discussion is that the author acknowledges the existence of a pattern of interdependence between this group of three countries and Russia. In her assessment, this dependence is asymmetric in favor of Russia.⁵⁶

⁵⁰ Goldthau, Andreas: "Rhetoric versus reality: Russian threats to European energy supply", *Energy Policy*, vol. 36, no. 2 (2008), pp. 686-692. As a complement to this, we may mention the short article published in 2012 (Henderson, James and Heather, Patrick: "Lessons from the February 2012 European gas 'crisis'", Oxford Institute for Energy Studies, Oxford Energy Comment (April 2012), at

<http://www.oxfordenergy.org/2012/04/lessons-from-the-february-2012-european-gas-%E2%80%9Ccrisis%E2%80%9D/>): the authors highlight how particularly cold weather in February 2012 led to supply problems for consumers in Europe, as Gazprom had to guarantee domestic supplies first.

⁵¹ See: Quester, George H.: "Energy dependence and political power: some paradoxes", *Democratizatsya*, vol. 15, no. 4 (2007), pp. 445-54.

⁵² Kropatcheva, *op. cit.*, pp. 555-556.

⁵³ Ericson, *op. cit.*, p. 33.

⁵⁴ *Ibid.*, p. 38.

⁵⁵ Balmaceda, "Politics of energy dependency", *op. cit.*

⁵⁶ *Ibid.*, pp. 30-31.

This question may remain open, as the frequency of disputes in the 90s and the long periods where transit countries managed to maintain subsidized prices could be interpreted as a sign of relative weakness from the side of Russia. Pavel Baev's consideration that Russia pursues economic optimization and suffers from an excessive leverage from the side of these transit countries⁵⁷ offers an opposed interpretation, where Russia is precisely the one who suffers this asymmetry.

The issue of interdependence between Russia and transit countries is the starting point for the focus of this work, as energy disputes are the most extreme phenomenon deriving from this reality and where the interdependence between Russia and the rest of Europe also becomes entangled in a complex triangular relation. Further below we will consider the literature existing on energy disputes. As for the degree of asymmetry regarding this dyad, our work may offer a contribution to determine it. In any case, as far as this literature review is concerned, the fact is that an analysis of this pattern of asymmetry, in the same way as for that between Russia and the EU, determines what is the margin of action Russia has. It may be argued that in this case, the interconnection between political and economic factors is arguably more complex and makes a clear assessment more difficult.

Other Narratives

Narratives sketched above present the image of a Russian rational and centralized energy policy, either for political or for strictly economic reasons. There are however other narratives that can be complemented with our discussion of Russian energy policy, which take into account alternative factors such as domestic politics, social construction of identity, issues that may introduce irrational actions or leave space to sub-state agents liable to hijack the state agenda and impose their particular interests.

Domestic politics

As for domestic politics, Jeffrey Mankoff offers some insights suggesting for example that the August 2008 war was engineered so as to force the liberal minded Medvedev to take a hard-line course.⁵⁸ His account in Chapter 2 "Dogs fighting under the rug" portrays Putin as a leader able to conveniently manipulate constituencies, as Eurasianist or Slav nationalists.⁵⁹ The author seems to portray Putin's system of power as dependent on these constituencies, but managing to chart a middle course and thus keep full control. The idea of the August 2008 war provoked for the sake of domestic interests (curtailing the autonomy of the liberal sectors), is suggestive of a very sophisticated and risky manipulation, this time aimed at a

⁵⁷ Baev, "From West to South to North", *op. cit.*, pp. 295, 299.

⁵⁸ Mankoff, *op. cit.*

⁵⁹ Whether constituencies hijacked the government or were hijacked themselves by it, does not seem clear.

constituency whose prospective influence is mistrusted. The reasoning could lead us to think that something similar might have happened in some of the energy disputes.

Social construction

Regarding social construction, we can take Sinikukka Saari when she states: "Sherr highlights that Russia's 'soft imperialism' has a strong psychological dimension and is not entirely based on calculus-based rationality",⁶⁰ and as the above-mentioned author himself, James Sherr, explains in his own article, Russian strategic conception of its "Near-Abroad" is defined in geopolitical terms identifying presence rather than intentions and capabilities,⁶¹ which points to a particular construction of threat, arguably not based on strict calculus-based rationality as Saari understands it, but rather on psychological reasons.

Sub-state agents

However, analyses devoted to the role of sub-state agents, are those that arguably offer us the most promising insights in relation to energy policy-making. This line of research has also been very present in studies of Russian foreign policy in general and in the debates about how power was centralized since the onset of Vladimir Putin's rule. It seems now to be generally accepted that Yeltsin's unlikely successor has managed to hold power in a much more effective way than his predecessor. Compared to the chaos of the 90s, Putin's rule (including Dmitri Medvedev's "Interregnum") might be seen as a time of stability and prosperity.⁶² With the advent of Putin, potentially contending interests among elites did not translate into paralysis: they seemed to be interested in accepting Putin's rule.⁶³ In the foreign policy realm, this stable support led to Putin being able in his first years to take pro-Western policy orientations that ran counter to

⁶⁰ Saari, Sinikukka: "Strategies for nurturing trust in the wider Black Sea region", *Southeast European and Black Sea Studies*, vol. 11, no. 3 (2011), p. 338.

⁶¹ Sherr, James: "Hard power in the Black Sea region: a dreaded but crippled instrument", *Southeast European and Black Sea Studies*, vol. 11, no. 3 (2011), p. 283.

⁶² With the collapse of the Soviet Union (McFaul, Michael (2001): *Russia's unfinished revolution: political change from Gorbachev to Putin*, Ithaca, N.Y., Cornell University Press.) following a dismal Perestroika (see: Goldman, Marshall (1991): *What went wrong with Perestroika*, New York: Norton. and Goldman, Marshall (1994): *Lost opportunity: why economic reforms in Russia have not worked*, New York, Norton) and leading to brutal economic decay and political instability, the incapacity of the government was manifest in the unrestrained freedom of oligarchs to spoil the state (see: Freeland, Chrystia (2000): *Sale of the century: Russia's wild ride from communism to capitalism*, New York, Crown Publishing and Goldman, Marshall (2003): *The privatization of Russia: Russian reform goes awry*, London; New York, Routledge). The bureaucracy, having opportunistically undermined Perestroika (Solnick, Steven L. (1998): *Stealing the State, control and collapse in Soviet institutions*, Cambridge, Mass., Harvard University Press, p. 3) remained divided during the 90s, where competing constituencies precluded the state to exert real control.

⁶³ Steen, Anton (2003): *Political elites and the new Russia: the power basis of Yeltsin's and Putin's regimes*, London; New York, Routledge Curzon.

some of his supporting elites' mindset.⁶⁴ That consensus also enabled him to sideline challenges to his authoritarian policies.⁶⁵

However, Putin's authoritarianism might have been more reliant on his base of support than it may apparently be. The characterization of a man who "*stake(s) out maximalist positions, accept(s) compromises when he encounters opposition, but then return(s) to the issue again when his position is stronger*",⁶⁶ may be more appropriate.⁶⁷ Did Putin manage to control fights among the so called *siloviki* dubbed by many as his main constituency?⁶⁸ Had Putin been forced to strike awkward balances between them and the more liberal sectors?⁶⁹ As Jørgen Staun suggests, events starting off with the YUKOS take-over (leading to Khodorkovsky's arrest and 10-year detention) and the many instances thereafter of Putin's calls for market friendly policies contradicted by measures in the opposite direction, could be seen as a proof of *siloviki*'s free-ride.⁷⁰ There exist some suggestions that murky affairs such as the assassination of Litvinenko might have responded to free-riding *siloviki* sectors trying to push for a third Putin term.⁷¹

⁶⁴ Bukkvol, Tor: "Putin's strategic partnership with the West: the domestic politics of Russian foreign policy", *Comparative Strategy*, vol. 22, no. 3 (2003), pp. 223-242

⁶⁵ On his attacks on the press, see: Shevtsova, Lilia (2007): *Russia lost in transition: the Yeltsin and Putin legacies*, Washington, DC, Carnegie Endowment for International Peace.

⁶⁶ Balzer, *op. cit.*, p. 211.

⁶⁷ Lilia Shevtsova's (Shevtsova, *op. cit.*) portrayal of Putin of someone who let his subordinates fight among each other leaving the impression he did not know what decision to take might show us a more nuanced view of the idea of Putin as an unchallenged autocrat. The saga of the ESPO Siberian Pipeline, with decisions being constantly changed as to whether the pipeline would reach the Pacific or China leaves questions unanswered about the full control of decision making. Whether this is intended or unintended, the opacity makes it difficult to assess.

⁶⁸ Jérôme Guillet for example (Guillet, Jérôme: "Gazprom as a predictable partner. Another reading of the Russian-Ukrainian and Russian-Belarusian energy crises", *IFRI, Russia/NIS Center* (March 2007), at www.ifri.org/downloads/ifri_Gazprom_guillet_anglais_mars2007.pdf), shows that in the Russia-Belarus gas crisis of January 2007, Russia unexpectedly renounced the favorable transit fee it had imposed on Minsk. The author suggests that bureaucratic interests were to blame, although it should be regarded as a mere conjecture. In general, *siloviki* are divided among those dealing with domestic politics and those dealing with international affairs, showing the former a bigger cohesion (Khryshtanovskaia, Ol'ga and White, Stephen: "Inside the Putin court: a research note", *Europe-Asia Studies*, vol. 57, no. 7 (November 2005), pp. 1070-71), although this is not necessarily suggestive of competitive relations among each other group. Andrei Tsygankov does however rely on news information to state that there exists a split (Tsygankov, "Russia's international assertiveness", *op. cit.*, p.54, ft. 19: "Siloviki Clash in Storchak Affair").

⁶⁹ Several authors come down with the categorization of elites as *siloviki* and liberals (or techno-liberals). See Staun, *op. cit.* and Kryshstanovskaia and White, *op. cit.*

⁷⁰ Staun, *op. cit.*, pp. 24-25.

⁷¹ Discussions pointing to that direction were recently revealed by Wikileaks. It is interesting to note how one of the interviewees in Kryshstanovskaia and White *op. cit.*, p. 1073, voiced the *siloviki*'s concern regarding Putin's prospective successor. Some studies however have both minimized the supposed ideological effect of the *siloviki* and their real numerical importance (Renz, Bettina: "Putin's militocracy? An alternative interpretation of Siloviki in contemporary Russian politics", *Europe-Asia Studies*, vol. 58, no. 6 (2006), pp. 903-924.; Rivera, Sharon W.; Rivera, David W.: "The Russian elite under Putin: militocratic or bourgeois?", *Post-Soviet Affairs*, vol. 22, no. 2 (2006), pp. 125-144; Baev, Pavel: "The evolution of Putin's regime inner circles and outer walls", *Problems of Post-Communism*, vol. 51, no. 6 (2004), pp 3-13.), as stated earlier (Khryshtanovskaia and White, *op. cit.*). As Sharon W. and David W. Rivera show, the presence of businessmen is much more significant in numerical terms (Rivera & Rivera, *op. cit.*). We should not assume that "liberals" are so close to our concept of power and democracy as we might think. As shown by Kryshstanovskaia and White, *op. cit.*, their differences in political issues are not very significant. The same author by the way, states that by 2008 (Khryshtanovskaia, Ol'ga: "The Russian elite in

When it comes to the energy sector, discussions regarding the degree of unity in the formulation of energy policy are also common. To begin with, we may start with Pami Aalto when he states in the introductory literature review to his edited work⁷² that most of the literature focusing on energy decision-making in Russia has highlighted deficiencies in the functioning of institutions. Margarita Balmaceda in the same publication deals with the institutional framework of Russian policy-making with a focus on competing rationality frames where state, business and personal rent-seeking interest intermingle.⁷³

Given that we are dealing with energy policy in the gas sector, our main focus should be Gazprom, as its agenda could have superseded that of the state. If that had happened, the government's decision-making process might have ended up being hijacked. In a more complicated twist, we might consider that behind the relations between the government and Gazprom, infighting between contending bureaucracies was in play.

Indeed, as Angela Stent expresses it, it is difficult to determine when politics and business start in the symbiotic relation between the Russian government and Gazprom.⁷⁴ In his analysis of Russian energy diplomacy, Adam Stulberg finds that the Russian government has been rather unsuccessful in controlling the state company responsible for the pipeline network, Transneft.⁷⁵ On the contrary, he does point to the fact that Gazprom, in spite of frequent clashes regarding energy policy when interests were opposed, has been generally very compliant with state priorities.⁷⁶ Margarita Balmaceda rejects simplistic portrayals of Russian energy policy as either entirely policy or business driven, and while not further dealing with the matter, she does provide us with an interesting vision of Gazprom as influenced by both business, state and personal rent-seeking interests. Whereas the latter seems to have affected mostly the period before the state's firmer control of the company (a process which lasted from 2001 to 2004),⁷⁷ it must be acknowledged that although pricing policy in the FSU differs much from country to country, leaving thus

transition", *Journal of Communist Studies and Transition Politics*, vol. 24, no. 4 (December 2008), pp. 585-603), the share of *siloviki* in the federal administration would have jumped to 42 % (*Ibid.*, p. 595).

⁷² Aalto, Pami: "Introduction", in Aalto, Pami (ed.) (2012): *Russia's energy policies: national, interregional and global levels*, Edward Elgar, Cheltenham, UK, Northampton, USA, p. 13.

⁷³ Balmaceda, Margarita: "Russia's central and eastern European energy transit corridor: Ukraine and Belarus", in Aalto, *op. cit.*, p. 140.

⁷⁴ Stent, Angela: "An energy superpower?: Russia and Europe", in Campbell, Kurt and Price, Jonathan (2008): *The global politics of energy*, Washington, DC, Aspen Institute, p. 79.

⁷⁵ Stulberg, Adam (2007): *Well-oiled diplomacy: strategic manipulation and Russia's energy statecraft in Eurasia*, Albany: State University of New York Press, chapter 5, pp. 133-178.

⁷⁶ *Ibid.*, p. 93-131.

⁷⁷ See: Nemtsov, Boris and Milov, Vladimir (2008): *Nezavisimyi' expertnyi' доклад: Putin i Gazprom*, Novaia Gazeta., pp. 8, 22 and Sorbello, Paolo and Grandi, Ludovico: "From concentration to competition: The struggle for power between the Kremlin and Gazprom through the study of TNK-BP and South-Stream", *Irish Slavonic Studies*, no. 25 (2013), pp. 109-110.

great room for political interests alien to a strictly business logic, price transitions towards business logic have been the norm compared to the subsidization policies of the 90s.⁷⁸ Markku Kivinen, who also deals with the debate of public and business actors in his own contribution to Pami Aalto,⁷⁹ builds a series of hypotheses, and tentatively concludes that the business frames seem to be dominating Russia's energy policy;⁸⁰ as Hanna Smith puts it: "*The behavior of Russian market players in the energy sector is far from free of political logic especially when it comes to export supplies. Nonetheless, a strong economic component is present in it and most steps are dictated by the objective of maximizing profits from hydrocarbon sales*".⁸¹ Another author, Stacy Closson, on the contrary, focuses on the Russian subsidy policy in the 2000s compared to similar policies in the Soviet period in relation to CMEA countries and concludes that: "*Putin transferred patterns of poor energy management from the CMEA to the former Soviet states. While he claimed to be ridding the trade of subsidies, unofficially it continued*";⁸² however, once we get the whole picture, the biggest share of subsidization seems to involve internal Russian market, whereas, as it has been stated before, subsidization in the CIS countries actually started being reversed in the 2000s. Although Prof. Closson highlights the backlash in political relations with CIS countries due to Russian energy projects, in particular those decisions to cut flows of gas in disputes, we would rather say that attempts at enforcing price markets, or as an alternative, at acquiring assets in exchange for accumulated debt or as a condition for maintaining subsidized prices, are the main reason for disputes.⁸³ Many authors in fact, follow the version of close state-Gazprom interests: Karen Smith Stegel for example finds anecdotal evidence of the state's control of Gazprom relying on President Medvedev's declarations that the 2010 pricing agreement with Ukraine helped to find an arrangement for the extension of the Black Sea Fleet, with Gazprom clearly offering a political price discount not in the business interests of the company;⁸⁴ Nina Poussenkova also underlines the closeness of relations of Gazprom (subordinated to the state) and the Russian government.⁸⁵ Mert Bilgin follows a similar

⁷⁸ Balmaceda, "Russia's central and eastern European energy transit corridor", *op. cit.*, pp. 138-147 and Casier, Tom: "The rise of energy to the top of the EU-Russia agenda: from interdependence to dependence?", *Geopolitics*, vol. 15, no. 3 (July 2011), p. 545.

⁷⁹ Kivinen, Markku: "Public and business actors in Russia's energy policy", in Aalto, *op. cit.*, pp. 45-62.

⁸⁰ *Ibid.*, p. 61.

⁸¹ Smith, Hanna: "Politicizing energy security: Russia and the European Union", in Oxenstierna, Susanne and Tynkkynen, Veli-Pekka (2014): *Russian energy and security up to 2030*, London, New York, Routledge, p. 89.

⁸² Closson, Stacy: "A comparative analysis on energy subsidies in Soviet and Russian policy", *Communist and Post-Communist Studies*, vol. 44, no. 4 (2011), p. 344.

⁸³ We find a flaw with Closson's parallelism between the USSR and Russian Federation's energy policies under Putin as both policy-motivated and unsuccessful (Closson, *op. cit.*, p. 349), as the failures that the author finds (*Ibid.*, pp. 352-353) look rather like the result of putting an end to such policies; the Russian policy of swaps for assets pursued in many CIS countries is rather political, but could also be seen as a "non-orthodox" market practice.

⁸⁴ Smith Stegel, Karen: "Deconstructing the "energy weapon": Russia's threat to Europe as case study", *Energy Policy*, vol. 39, no. 10 (2011), p. 6506.

⁸⁵ Poussenkova, *op. cit.*, pp. 103-124.

narrative when she highlights Gazprom's and the state's symbiotic relation, with the latter supporting both Gazprom's expansion abroad and its monopolistic role in Russian domestic market, while the former secures for the state coffers a stable financial flow;⁸⁶ indeed, as we can read in Kalman Kalotay: *"Until 1999, the latter occupied an undoubted dominant position in their relationship. Since then, the power balance has tilted gradually in favor of the state"*.⁸⁷ In the case of Gazprom, the stronger the role of the state has become, the lower the subsidization of the FSU market has become, which arguably confirms the assumption that the state has assumed as its own the business interests of the company and has reinforced a symbiotic relationship around financial interests as the bedrock of their common relations.

However, acknowledging that both Gazprom and the Russian state consistently maintain their support for business logic does not mean in itself that they do support exactly the same strategies and tactics when confronting certain dilemmas. As Andreas Heinrich stated in 2006: *"In this area (the international level beyond the CIS), Gazprom pursues an independent policy that is in line with the market, and seeks cooperation with transit and customer states in Western Europe (...) The Russian government's support for the company in this sector is limited to creating favorable framework conditions, as is customary in Western countries as well"*.⁸⁸ If beyond the CIS the state supports Gazprom's business strategies, the situation in the CIS countries, while different as far as it concerns a strictly business logic, seems nevertheless to show a similar coincidence of interests between Gazprom and the state, with the latter pursuing an active support. The main difference may lie here not just in the fact that the legacy of subsidized prices has to be overcome, but in the "non-orthodox" (but nevertheless, may we say, at least partly) business logic of swapping accumulated debts with the cession of transportation facilities of transit countries such as Belarus and Ukraine or control of end-suppliers' assets as in Central Asia and the Caucasus. In relation to these countries, Russia has been consistently aspiring to a position of monopoly and monopsony as for direct access to other countries within and without the CIS.

⁸⁶ Bilgin, Mert: "Energy security and Russia's gas strategy: The symbiotic relationship between the state and firms", *Communist and Post-Communist Studies*, vol. 44, no. 2 (2011), pp. 119-127. We could add here what Balmaceda mentions in her chapter in Pami Aalto's book to support this narrative of symbiosis: the Russian state secures for Gazprom a role as monopolist in the domestic market in exchange for subsidized prices (political factor), which after all, can be seen not just as a concession by Gazprom, but also a long-term investment, as subsidization in itself further undermines other potential actors in the energy market and reinforces Gazprom's monopoly (Balmaceda in Aalto, *op. cit.*, pp. 143-144). In an interesting article, Marina Tsygankova uses a model to show that Gazprom's export monopoly since June 2006 is also a guarantee that domestic prices will not rise, as this forces many independent producers to sell at home volumes they would otherwise export with its detrimental effect on prices paid by Russian consumers (Tsygankova, Marina: "An evaluation of alternative scenarios for the Gazprom monopoly of Russian gas exports", *Energy Economics*, vol. 34, no. 1 (2012), pp. 153-161.); whether this was one of the reasons for the Russian government to establish such monopoly, the article does not clarify.

⁸⁷ Kalman, Kalotay: "Russian transnationals and international investment paradigms", *Research in International Business and Finance*, vol. 22, no. 2 (2008), p. 98.

⁸⁸ Heinrich, Andreas: "Gazprom – a reliable partner for Europe's energy supply?", *Russian Analytical Digest* (Jan. 2006), at <http://www.css.ethz.ch/publications/pdfs/RAD-1-2-6.pdf>, p. 5.

However, as already stated, both Russian diplomacy and Gazprom have coordinated themselves fairly well when it came to enforce (or rather try to enforce) policies to acquire transport assets in Belarus and Ukraine, with some success in the former but adamant opposition from the side of the latter. If background divergences unnoticed to the observer did take place, either Gazprom or the government systematically yielded to each other with few hints of lack of coordination.

An obscure point however, seems to be Gazprom's relation with intermediaries. These companies have been very active in Russia-Ukraine energy relations, where personal interests alien to either the state or Gazprom have frequently appeared. The ubiquity of these companies raises the question of whether both Gazprom and the Russian state were unable to control or were on the contrary in agreement with the former. In the case of Itera, which functioned from the mid-90s, this was clearly a vehicle for self-enrichment of Gazprom's own leadership. Thus it worked against the company's interests for the sake of the personal interests' of its own members. Although Rem Viakhirev's leadership ended and was substituted by that of Alexei Miller in 2002, the company worked as an intermediary until 2003. As full state control of Gazprom did not ensue until 2004, the resilience of Itera might be easily explained by the slow pace of Alexei Miller's progressive control. However, other intermediary companies continued to operate until 2009. EuralTransGaz and RosUkrEnergo were the two successors of Itera, with the role of the latter, as we will later see, even expanded after January 2006. As in other topics pertaining to both Russian foreign policy in general and energy policy in particular, there are different interpretations: writing in 2006, Margarita Balmaceda hinted that these new intermediaries could have played the same role of vehicles of self-enrichment for Gazprom's leadership as had been the case with Itera.⁸⁹ Another narrative regarding intermediaries justifies their existence as vehicles to enforce strategic objectives, such as asset acquisition in transit countries. This is the case made for example by Stacy Closson⁹⁰ and which has been extensively voiced in the Ukrainian press, as for example *Zerkalo Nedeli* and *Ukrainska Pravda*. Margarita Balmaceda touches on this topic again in subsequent publications and as for the changes that took place since 2001 when the Russian government started to have a firmer control of Gazprom, she joins this narrative when pointing to the upholding of these actors as strategic assets to maintain good contacts with local actors.⁹¹ She expands the rationale for this interpretation while analyzing the case study of Lithuania, where Gazprom's new intermediary in Lithuania, Dujotekana, established a complex

⁸⁹ Balmaceda, Margarita: "Russian energy companies in the new Eastern Europe: the cases of Ukraine and Belarus" in Wenger, Andreas; Perovic, Jeronim & Orttung, Robert (eds.) (2006): *Russian business power: the role of Russian business in foreign and security relations*, London and New York, Routledge, pp. 70-71).

⁹⁰ Closson, *op. cit.*, p. 352.

⁹¹ Balmaceda, Margarita: "Corruption, intermediary companies, and energy security: Lithuania's lessons for Central and Eastern Europe", *Problems of Post-Communism*, vol. 55, no. 4 (2008), p. 20.

web of interests with local businessmen and members of the secret services. The intermediary thus played a different role to that of its predecessor. Enriching officials from Gazprom ceased being the sole goal, superseded by the more complex goal of maintaining a network of allies within Lithuania who would help the company's strategy. Drawing the parallel with Ukraine, Balmaceda interprets the expanded role of RosUkrEnergo in 2006 in a similar fashion, possibly in this case too, for the sake of expanding the network of corruption in Ukraine and solidifying the basis of its allies.⁹² As for what exactly these interests may have been, the author provides some clues: regarding Lithuania, she puts forward that the role played by Dujotekana was devised to use Lithuania as a bridgehead into the EU or to use it eventually in order to foster divisions within the EU.⁹³ In the extrapolation to the Ukrainian case the author simply puts forward the assumption that RosUkrEnergo's objectives may have been political or geopolitical.⁹⁴ The way we could term these intermediaries under this narrative could be that of "strategic vehicles". Roman Kupchinsky is a strong proponent of Gazprom's strategic rationale for building a network of intermediaries in many transit and consumer countries.⁹⁵ However, conclusions in this respect cannot be definitive because of the high level of opacity. If evidence for the enrichment narrative is clear in the case of Itera and it seems warranted to assign a strategic role to its successors, it is nevertheless more complicated to prove in the case of EuralTransGaz and RosUkrEnergo what was the exact goal they were assigned. In this respect, it must also be highlighted that for some authors intermediaries should be considered more as "strategic buffers" than "strategic vehicles". The main difference between the two definitions lies in the fact that under the term of "strategic buffers", intermediaries are understood more for their defensive nature than as a tool for expansion, serving rather as insurance against liabilities related to transit countries. Peter Ševce from the Energy Security Institute (Slovakia), considers that intermediaries in Ukraine may have been established to fight chronic problems deriving from irregularities in the Ukrainian side as well as to impose contracts on Ukraine more effectively than Gazprom.⁹⁶ As Margarita Balmaceda again explains, lending support to this line of interpretation too, the

⁹² *Ibid.*, pp. 24-25 (The author explicitly identifies RosUkrEnergo as the inheritor of personal interests within Gazprom then possibly linked to Russian state interests; see: Balmaceda, "Energy dependence, politics and corruption in the former Soviet Union", *op. cit.*, p. 25).

⁹³ *Ibid.*, p. 25.

⁹⁴ *Ibid.*, *Idem.*

⁹⁵ Kupchinsky, Roman (2009): *Gazprom's European web*, Jamestown Foundation, Washington DC.

⁹⁶ Ševce, Peter: "The role of intermediary companies in Russian-Ukrainian relations and implications for the countries of Central Europe", *Central and Eastern European Watch* (2006), p. 3, at http://www.despiteborders.com/clanky/data/upimages/sprostredkovadelske_spolocnosti_ang.pdf.

rationale for the existence of intermediaries was their role to get around liquidity problems, restructure non-performing loans, find out complex barter schemes or actually transfer kickbacks.⁹⁷

The limited literature above points to a certain degree of complexity concerning relations between the Russian state and Gazprom. Clarifying the degree of independence of Gazprom in relation to the state should be crucial, as my assumption in this work is precisely that Gazprom was subordinated to the state and that we may therefore expect a high degree of coordination. This assumption is justified given the process of centralization that was undertaken under Putin and because the three disputes under analysis here fall within the period when this centralization had been completed.

That the state and Gazprom's interests diverge is something that the literature review above can testify. That this divergence has found a stable "modus vivendi" is also manifest in the trade-off between Gazprom's subsidization of Russian customers, which runs counter to the company's interests and its being maintained as the gas monopoly in exchange. Regarding the price revisions that were imposed on Ukraine from 2005 to 2009 and which will be analyzed in chapters 6, 7 and 8, these moves go precisely in the direction of what are Gazprom's interests and were not only assumed, but primarily promoted from the government. Even if we imagined that the government was being manipulated by Gazprom and blindly followed its strategy (something not quite plausible), we can assume a notable coherence during the above-mentioned period, where the strategy of price revisions was maintained.

Furthermore, tensions between Gazprom and the state influencing the outcomes ought not necessarily to result in "incoherence", namely, the Russian side's response not being in line with fluctuations of the general context. A lessened or increased role for Gazprom in the management of the disputes (either negotiations before or the dispute in itself) could precisely respond to these circumstances. The Russian state could have for example either enabled a more restrained business-like strategy in disputes where the stakes were not that high, while imposing its agenda on Gazprom in cases where the stakes were higher. If Gazprom was a hardliner and the state a softliner, the state could have restrained Gazprom when needed, and then switched to Gazprom's hard-line policy when it suited best. If we want to consider a reversed hierarchy, a similar process could have taken place but in reverse. Differences between Gazprom and the state along with the influence on the outcome of each of the disputes could be subsumed in the process of how circumstances influenced decision taking and the eventual outcome.

⁹⁷ Balmaceda, "Corruption, intermediary companies, and energy security", *op. cit.*, pp. 18-19.

In any case, even if the current literature can hardly produce hard proof of the relation between Gazprom and the Russian state, it does point to a subordination of the former to the latter and a coherent strategy, where existing divergences seem to have resulted in compromises. Proof to the contrary does not seem to have been produced to date. The plausibility test points to this and we may thus, for the sake of parsimony, assume a unitary actor during the process of the three disputes that took place from 2005 to 2009. If divergences between Gazprom and the state are revealed in the future to be more important than expected, they should not have affected the core of the problem. Any additional information on Gazprom and the Russian state that may be discovered in chapters 6-8 will be further discussed in the conclusions.

2. 3. Energy Disputes

In the article by Robert Orttung and Indra Overland mentioned above, "A limited toolbox: explaining the constraints on Russia's foreign energy policy",⁹⁸ the authors listed 31 energy disputes with more than 20 countries from 2000 to 2010. To these disputes we should add those that already took place back in the decade of the 90s. Among these earlier disputes, Russian cut-offs to Ukraine both in September 1993 and November 1994 stand out.⁹⁹ The main disputes involving transit countries and thus having had an unwanted effect on final consumers have centered on three transit countries, Belarus, Ukraine and Moldova. Excepting the single 2006 dispute with Moldova,¹⁰⁰ Belarus and Ukraine, both because of the frequency of disputes and because of the fact that most of the gas bound for Europe transits through them (20 % in the case of Belarus and 80 % in the case of Ukraine for the period 2005-2009), have been the main actors in these kind of disputes. Gas is more conflict-prone, as gas cut-offs are clearly more sensitive due to the lesser gas reserves in comparison to the existing reserves of oil in many consumer countries in Europe, as well as the lesser outlets both connecting to downstream production in Russia and to alternative sources. As Richard E. Ericson puts it, *"Because of the peculiar technological and economic characteristics of acquisition and use of natural gas as an energy carrier, and in particular its infrastructure requirements, gas "markets" are highly inflexible and political"*.¹⁰¹ The shale gas and LNG revolution are arguably

⁹⁸ Orttung & Overland, *op. cit.*

⁹⁹ Stern, Jonathan (2005): *The future of Russian gas and Gazprom*, Oxford; New York, Oxford University Press; Mabro, Robert and Wybrew-Bond, Ian (1999): *Gas to Europe: the strategies of four major suppliers*, Oxford; New York, Oxford University Press and Pirani, Simon: "Ukraine's gas sector", Oxford Energy Institute (2007), at <http://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG21-UkrainesGasSector-SimonPirani-2007.pdf>.

¹⁰⁰ See: Bruce, Chloe and Yafimava, Katja: "Moldova's gas sector", in Pirani, Simon (ed.) (2009): *Russia and CIS gas markets and their impact on Europe*, Oxford, Oxford University Press, pp. 182-183.

¹⁰¹ Ericson, Richard E.: "Eurasian natural gas pipelines: the political economy of network interdependence", *Eurasia Geography and Economics*, vol. 50, no. 1 (Jan-Feb 2009), p. 28.

changing the situation, but that was nevertheless not the case yet at the time when these disputes took place. As opposed to gas, oil is sold in the world market and any cuts can be easily compensated for by further purchases in the spot market.¹⁰² Gas is more dependent on long term bilateral contracts linked to gas pipelines, so not only is the power relation in pricing negotiations stronger, but it is also more difficult to switch to other suppliers when confronted to troublesome partners.¹⁰³

Russia-Belarus Gas Disputes

The first significant dispute between Russia and Belarus happened in 2004. Before that, Belarus, like most of the CIS states, had been supplied with cheap subsidized Russian gas without seriously considering that Russia might eventually separate energy supplies from political issues such as the Belarus-Russia integration process.¹⁰⁴ Belarus enjoyed a value-added advantage compared to Ukraine, as it could partly solve the uncomfortable quasi-monopoly as transit country that the neighboring Ukraine enjoyed. This position represented an important asset and was determinant in the plans spawned in the decade of the 90s of bypassing Ukraine.¹⁰⁵ The down-scaled result of these schemes is the Yamal-Europe pipeline which started in 1999 and reached full capacity in 2006. However, in spite of the comparative stability (the situation in Ukraine was far more chaotic and unpredictable), the fact is that as was the case in Ukraine, disputes were very common.¹⁰⁶ With the advent of Vladimir Putin, Russia started unlinking politics and economics. Turning away from geopolitics and towards geo-economics, Russia started demanding market prices. The January-February 2004 energy dispute, the first in which Gazprom went as far as to stop supplies bound for Europe, was the result. As Belarus refused to sign an agreement to raise gas prices from US\$30tcm to US\$50tcm, Gazprom stopped supplies through the Northern Lights pipeline on the 1st January 2004 and left Belarus with supplies on a short term contract basis provided by Itera, Transnafta and Sibur (averaging US\$46.68tcm). Belarus, which by the 18th February was facing the end of the short term contracts, far from bending to pressure, started siphoning gas off bound for Europe from the Yamal-Europe pipeline. Russia then decided to stop gas supplies altogether, thus affecting other consumers (Germany, Poland, Lithuania, and the Russian Kaliningrad enclave). The cut-off barely affected European consumers, first, because of the limited amounts of gas involved (Germany received 90% of its supplies via Ukraine),

¹⁰² Goldthau, Andreas: "Resurgent Russia? Rethinking Energy Inc.", *Policy Review*, n° 147 (Feb-March 2008), p. 55.

¹⁰³ Levi, Michael A.: "Energy security: an agenda for research", Council on Foreign Relations, *Working Paper* (June 2010), at <http://www.cfr.org/energy-security/energy-security/p22427>, pp. 11-12.

¹⁰⁴ Yafimava, Katja: "Belarus: domestic gas market and relations with Russia", in Pirani, "Russia and CIS gas markets", *op. cit.*; Balmaceda, "Oil, gas, transit pipelines", *op. cit.* and Bruce, "Fraternal friction or fraternal fiction?", *op. cit.*

¹⁰⁵ See: Victor, David & Victor, Nadejda Makarova: "The Belarus connection: exporting Russian gas to Germany and Poland", *geopolitics of gas working paper series*, Baker Center, Stanford (August 2004), at http://iis-db.stanford.edu/pubs/20603/Yamal_final.pdf.

¹⁰⁶ From 1993 to 2004, only three years did not witness any dispute; see: *Ibid.*, pp. 2; 8.

second, because additional Russian supplies could come from alternative routes (that helped mostly Lithuania) and most importantly, because a new short term stopgap contract was soon agreed. Thus, the cut-off, which lasted for one day, only really affected Poland. A final agreement was reached in June, with Belarus being supplied with gas for the rest of the year at US\$46.68tcm, whereas transit fees would rise to US\$0.75tcm/100km from US\$0.53tcm/100km via the Northern Lights pipeline and to US\$0.43tcm/100km from US\$0.36tcm/100km via the Yamal-Europe pipeline.¹⁰⁷ It was additionally agreed that Beltransgaz would be assessed so as to determine the price of its assets. This assessment was the first step to turn the company into a Joint Venture where Gazprom would enjoy co-ownership (the first agreement about this aspect dated from 2002).¹⁰⁸ However, despite the fact that Belarus had been able to avert a significant increase of gas prices, Gazprom started demanding higher prices (US\$200tcm) when negotiating prices for 2007, while disagreements also surfaced regarding the price assets of Beltransgaz. A dispute was averted at the very last moment before the 1st January 2007 (Instead, both countries started an oil dispute)¹⁰⁹. The agreement reached foresaw an increase of the supply prices to US\$100tcm from US\$46.68tcm, a timetable of progressive increases towards market prices which should lead to European prices by 2011 and transit fees for gas transiting through the Northern Lights pipeline rising to US\$1.45tcm/100km from US\$0.75tcm/100km. Regarding Beltransgaz, the agreement foresaw an accord by June 2007 regarding the sale of 50% of the state company to Gazprom. The first 12,5% was sold to Gazprom on 6th June.¹¹⁰

The next significant gas dispute between Russia and Belarus happened in June 2010. The 2007 agreement had left undetermined the reference for calculating European market prices and the relation between prices and transit fees.¹¹¹ In addition to that, Belarus, which was heavily hit by the 2008 financial crisis and the January 2010 changes in the Russian oil export regime and was at the same time fearful of diminished leverage after the prospective completion of the Nord Stream in 2012, had new incentives to push for a revision.¹¹² Thus, in April 2010, Belarus offered Gazprom a draft agreement to push transition to European prices to 2014-15, instead of 2011 as had been agreed in 2007. Gazprom balked and also rejected an offer to keep prices subsidized in exchange for new shares in Beltransgaz, of which it already

¹⁰⁷ Yafimava, "Belarus", *op. cit.*, p. 155.

¹⁰⁸ For a background discussion on the status of Beltransgaz and Russian intentions to have ownership access to the company, see: Balmaceda, "Oil, gas, transit Pipelines", *op. cit.*, pp. 23-25. A similar agreement had been already signed in 1993, but after Belarusian refusal to sign the contract (Bruce, "Fraternal friction or fraternal fiction?", *op. cit.*, p. 8), the issue faded for most of the decade.

¹⁰⁹ Varró, László: "Here we go again: the January 2007 transit crisis between Russia and Belarus", *Revue de l'Energie*, vol. 58, no. 579 (Sept-Oct. 2007), pp. 314-320.

¹¹⁰ Yafimava, "Belarus", *op. cit.*, pp. 157-158.

¹¹¹ Yafimava, Katja: "The June 2010 Russian-Belarusian gas transit dispute: a surprise that was to be expected", Oxford Institute for Energy Studies, (2010), at www.oxfordenergy.org/pdfs/NG43.pdf, pp. 4-5.

¹¹² *Ibid.*, pp. 1-2; 7.

owned 50%.¹¹³ The situation became explosive in June 2010 as Belarus, which had refused to pay more than US\$150tcm, was confronted with an increased debt (US\$192 mill). Russia accordingly started reducing gas supply in equivalence to the outstanding debt. Belarus, which started demanding alleged debts for transit fees, threatened to divert gas bound to Europe, as it had done in 2004 and as Ukraine had done in 2006 and 2009. Reports on 23rd June from Lithuania suggested that problems of gas delivery were taking place, this possibly meaning that gas was being diverted by Belarus, but as Belarus fully paid its debt that same day, supplies were subsequently restored. A new stage in the dispute ensued when Belarus started demanding debts that Gazprom owed for transit fees, which led to a renewing of the threat to halt any supplies (initially gas and later oil too) transiting its territory if there was no payment the following day. As Belarus subsequently made the timetable more flexible, Gazprom eventually managed to pay the debts and further transit disruptions were averted.¹¹⁴

If prices in general have tended to rise more slowly for Belarus compared to Ukraine under Yushchenko, Minsk's readiness to trade prices for assets (Russian co-ownership of Beltransgaz) might support economic rather than political arguments. The fact that Russia applied total cut-offs in disputes both for oil (Russia cut off oil to Belarus, extending the cut to any oil bound for Europe after Belarus started siphoning off oil in January 2007) and for gas (as seen above in February 2004), could also be explained by the fact that strategic oil reserves are larger and outlets for diversification in case of emergency are more developed for oil than gas, and because whereas 80% of gas bound for Europe transited through Ukraine, the figure was only 20% for Belarus.

Russia-Ukraine Gas Disputes

The January 2006 dispute between Russia and Ukraine was already explained by Jonathan Stern in that same month (to be later complemented by an article on the same topic)^{115:116} The background to that dispute came from the rejection upon the arrival of Viktor Yushchenko to the Presidency in January 2005 of the agreement of August 2004. That agreement contained provisions regarding delivery prices and transit fees, a resolution for the standing debts and the management and upgrading of the pipeline system through a consortium by both Gazprom and Naftohaz. The new political era started with Yushchenko reinstating the pattern of Ukrainian non-payments, Russian disruptions and Ukrainian siphoning gas off

¹¹³ *Ibid.*, p. 7.

¹¹⁴ *Ibid.*, pp. 10-12.

¹¹⁵ Stern, Jonathan: "Natural gas security problems in Europe: the Russian-Ukrainian crisis of 2006", *Asia-Pacific Review*, vol. 13, no. 1 (2006), pp. 32-59.

¹¹⁶ Stern, "The Russian-Ukrainian gas crisis", *op. cit.*

which characterized the relation in the 90s.¹¹⁷ Two particular elements coincided in 2005. From one side, after the new Ukrainian administration itself showed eagerness to bring energy relations into a market framework, Gazprom considered the 2004 agreement nullified, so it proposed the same as for gas deliveries and as a result started demanding higher market prices.¹¹⁸ From the other, conditions for the gas supply from Central Asia were becoming more unstable, with Turkmenistan trying to push up the prices for its gas too. Ashgabat kept sending contradictory signals throughout 2005 regarding prices and supply (after having cut supplies temporarily to both Ukraine and Russia over price disagreements in January 2005) and finally sold all of its gas exports to Gazprom (among which were included supplies for Ukraine). Russia then unsuccessfully tried to bargain on a price ranging from US\$160tcm to US\$230tcm from the US\$50tcm that had been agreed in 2004. As Ukraine balked, Gazprom cut off supplies on January 1st and Ukraine retaliated by siphoning off gas bound for Europe. The crisis lasted four days until the early hours of 4th January, when both parties reached an agreement.

Because of the big impact the dispute had on gas supplies, many were the commentaries on the dispute: Putin's blunt assertion in an interview for the German TV Channel ZDF stating that *"if anyone wants to support certain [political] forces [in Ukraine], then by all means, only not on our account"* do of course lend credence to strictly motivated political reasons¹¹⁹ and easily invoke the image of the Russian "bully". However, many analysts preferred to focus on the economic reasons for the dispute, as can be seen in Angela Stent,¹²⁰ even if with different combinations of strictly economic and political factors. Gilles Dubien for example, while acknowledging the underlying economic rationale, saw in Russian insistence on taking advantage of the Ukrainian decision to modify the gas agreements a political motivation related to the Orange Revolution with the intention of making these negotiations an "example" of its new energy diplomacy.¹²¹ Chow and Elkind introduce an interesting assessment when they consider that in the 2006 energy dispute, after four days, Russia backed down from its initial pretensions in the face of widespread European criticism.¹²² This assessment contradicts the image of a powerful Russia

¹¹⁷ Stern, "Natural gas security problems in Europe", *op. cit.*, p. 34.

¹¹⁸ Dubien, Arnaud: "L'Énergie, vulnérabilité stratégique persistante de l'Ukraine", *Revue d'Etudes comparatives Est-Ouest*, vol. 37, no. 4 (September 2006), p. 9; Stern, "The Russian-Ukrainian gas crisis", *op. cit.*, p. 5 and Abdelal, Rawi: "The profits of power: commercial realpolitik in Europe and Eurasia", Harvard Business School (2010), pp.18-19.

¹¹⁹ The translation is taken from Derek Averre (Averre, Derek: "'Sovereign Democracy' and Russia's Relations with the European Union", *Demokratizatsiya*, vol. 15, no. 2 (2007), p. 176), while the article transcripts can be found in http://www.mid.ru/brp_4.nsf/sps/7ADA345932B71CFAC32571AB002133D6.

¹²⁰ Stent, Angela: "An energy superpower? Russia and Europe" in Campbell & Price: "The global politics of energy", *op. cit.*, pp. 80-81.

¹²¹ Dubien, Gilles: "The opacity of Russian-Ukrainian energy relations", IFRI, *Russie.Nei.Visions* (May 2007), at http://www.ifri.org/?page=contribution-detail&id=4800&id_provenance=97, p. 10.

¹²² Chow, Edward and Elkind, Jonathan: "Where East meets West: European gas and Ukrainian reality", *Washington Quarterly*, vol. 32, no. 1 (2009 January), p. 82.

abusing a much weaker Ukraine. Other authors such as Pavel Baev seem to follow the same line of Putin's miscalculation in starting a crisis without guessing the prospective negative effects for Russia in underestimating the Ukrainian leverage,¹²³ with Arkady Moshes pointing out that the agreements were far below the initial Russian demands.¹²⁴ These authors thus support the idea of a Russian "defeat" in the face of Ukraine's decision to siphon gas off and to disrupt the gas flow to Europe. Pirani, Yafimava and Stern make a similar statement, pointing to Russia's frustrated attempt to enforce market prices in the face of Ukraine's use of transit gas as a negotiating chip.¹²⁵ Rawi Abdelal on the contrary, while acknowledging the fact that Russia did not fully achieve its objectives, highlights the positive aspects for Russia, namely the fact that the transition to market prices started, and the negative aspects for Ukraine, who lost in global terms with the new agreement.¹²⁶

Assessments regarding who was the victor in the dispute are particularly difficult with regard to the January 2006 dispute because of the arrangement pertaining to RosUkrEnergo, as the intermediary became the importer of all Central Asian gas supplied to Ukraine. Was it an outcome preferred by Ukraine or Russia? Gazprom's interests might have laid in the possibility of bankrupting Naftohaz (and bringing forward a future privatization).¹²⁷ Another undeniable fact is the involvement of many personalities from the former Kuchma Administration in the creation of RosUkrEnergo back in 2004 (thus allegedly rather "pro-Russian"). Simon Pirani considers RosUkrEnergo as an ally of Gazprom considering its stake of 50 % in the company,¹²⁸ but it is nevertheless hard to know whether at that time RosUkrEnergo's prominent role stemmed from Yushchenko (who supported Dmytro Firtash, main owner of Centragas, representing 50% of the intermediary) or from Gazprom (who owned the other half of the intermediary).¹²⁹ This matter will be dealt with again in Chapter 6.

The March 2008 energy dispute was much more limited in its scope and was not therefore the object of much attention beyond the press reports at the time. This is understandable given the fact that

¹²³ Baev, Pavel (2008): *Russian energy policy and military power: Putin's quest for greatness*, New York, Routledge, p. 298.

¹²⁴ Moshes, Arkady: "Change in the air in Ukraine", *Russia in Global Affairs*, no. 2 (April-June 2006).

¹²⁵ Pirani, Stern & Yafimava, Katja, *op. cit.*

¹²⁶ Abdelal, *op. cit.*, p. 22.

¹²⁷ See: Dubien (Arnaud), *op. cit.*, p.12, who echoes these concerns.

¹²⁸ Pirani, Simon: "A gas dependent state", in Pirani, *op.cit.*, p. 101.

¹²⁹ Actually many press analyses revealed the stakes President Yushchenko had in RosUkrEnergo (RUE). The Russian side did take part in the creation of RosUkrEnergo in 2004, substituting the previous arrangement around the shady EuralTransGas (ETG). Actually in the course of negotiations, Gazprom pressured Naftohaz to establish a joint venture excluding private actors, something at which the latter persistently balked (see: Global Witness: "It's a gas. Funny business in the Turkmen-Ukraine gas trade" (April 2006), at <http://www.globalwitness.org/library/its-gas-funny-business-turkmen-ukraine-gas-trade>). Before the 2006 crisis, Gazprom had raised that idea too (Dubien (Arnaud), *op. cit.*, p. 9) but still, the outcome ended up involving again shady ownership arrangements which centered around Dmytro Firtash, who should be seen rather as a late ally of Yushchenko (He was said to have approached him after his victory in the 2004 elections).

this dispute did not reach the stage of extensive gas cuts translating into supply distortions for end-consumers in Central Europe as two years before. The reason the dispute started was because of debt accumulation and mainly because the government by Timoshenko refused to honor a previous agreement reached by presidents Yushchenko and Putin in mid-February which solved the debt problem and guaranteed Gazprom its expansion into the internal Ukrainian market in substitution of the internal intermediary UkrGazEnergo. Timoshenko demanded instead an immediate suppression of both UkrGazEnergo and RosUkrEnergo and balked both at paying outstanding debts from 2007 and those accumulated since January 2008 for Russian gas sold extraordinarily in substitution for reduced supplies from Central Asia.¹³⁰ Gazprom then reacted by imposing an accumulated cut in supplies of 50% (by 25% on 3rd March followed by a similar cut the next day). Ukraine responded warning that further cuts causing supply problems within the country could translate into undersupply to customers in the rest of Europe. That was probably intended as a veiled threat, the result of which was the early end of the dispute. Gazprom decided to de-escalate the dispute and to restore supplies while negotiations continued. Finally a new agreement was reached on 14th of March.

The last dispute, in January 2009, originated for reasons similar to those of three years ago. Discussions on the final prices for 2009, which were supposed to absorb increases for Central Asian gas,¹³¹ were blocked by late 2008 due to new debt accumulated by the Ukrainian side. Russia insisted on its resolution before any discussion on prices continued. Besides, the general situation was much more complicated than three years before: the onset of the financial crisis, putting both Ukraine and Russia in very delicate positions, could have made bargaining positions even more intransigent. Initial prospects for successful negotiations were high. Agreements reached in March 2008 served as the basis for a detailed memorandum which was agreed in October 2008. The memorandum foresaw a regime of direct export (no intermediaries) from January 2009, a three year timetable for the introduction of market prices both for imports and for transit fees, guarantees for safe transit of gas to Europe and a joint export scheme of gas to Europe.¹³² However, with debts only repaid on the eve of the new year,¹³³ there was not enough time for an agreement on prices to be reached, even if positions had neared with Gazprom demanding

¹³⁰ Unusually cold weather led to a spike in consumption that translated in less gas available to honor export contracts.

¹³¹ Since January 2006 Ukraine almost exclusively imported gas from Central Asia. Prices from Central Asia had been increasing on a yearly basis since then; in 2008 Central Asian countries had been warning of market prices which would jump to US\$340/tcm (Perovic, Jeronim: "Farce um Gas: Russland, die Ukraine und die EU-Energiepolitik", *Osteuropa*, vol. 59, no. 1 (2009), pp. 25-26).

¹³² Pirani, Stern & Yafimava, *op. cit.*, p. 13.

¹³³ This was arguably caused by the catastrophic financial situation of Ukraine (*Ibid.*, p. 15); The delicate financial situation might have had a strong effect on Gazprom, as dramatically falling revenues made it even more imperative to collect outstanding debts (*Ibid.*, p. 17).

US\$250tcm and Naftohaz on the contrary demanding US\$235tcm. Gazprom, which since early on, had threatened with a price of US\$415tcm for 2009 in the event of no agreement being reached,¹³⁴ made its threat real and took the decision to stop gas supplies for Ukraine.

After Gazprom took the decision to stop supplies, the sequence of events was very similar to three years before. As Ukraine had already warned in the March 2008 dispute, it would siphon gas off bound for Europe in case of need. This in fact seemed to happen since the first day, as Ukraine accused Gazprom of having stopped supplies including technical gas needed to power pipelines that transported gas to Europe. As Ukraine made Gazprom responsible for its supply, it simply took it from the volumes of gas that were exported to the rest of Europe. As this stage was reached, the Russian reaction changed as compared to the January 2006 dispute. If by 4th January 2006 an agreement had been reached, on 5th January 2009, Putin personally ordered Alexei Miller to start reducing the flow of gas according to the volumes diverted, which meant that for the first time since February 2004, Russia would take the step of stopping natural gas supplies for Europe altogether. Amid contradicting allegations from Naftohaz and Gazprom, the fact is that by 7th January, gas flows to Europe dried up completely. This cut-off involving near to 80% of Russian gas supplies to Central and Western Europe, was to last an unprecedented 13 days.¹³⁵ By 12th January a monitoring agreement was reached with the European Union. However the gas flows could not be restored as Russia tried to restart pumping gas through inlets connected to pipelines which were being used by Ukraine in reverse mode with gas from storage facilities located in Western Ukraine. The crisis continued only to find a solution not earlier than on 19th January. That day a final agreement was reached and the next day, gas started flowing again both for Ukraine and Europe. According to the new agreement, the new price would be henceforth calculated on the basis of European prices (possibly German prices) with a discount of 20%. New prices would thus amount to US\$360 for the first quarter of 2009, updated henceforth every quarter of the year, on the basis of oil prices' average of the three previous quarters. Transit fees would remain unchanged for the current year, whereas intermediaries such as RosUkrEnergo would be eliminated under the promise of establishing a joint venture by Gazprom and Naftohaz.¹³⁶

As with the general discussion in both academia and media, the same fault lines resurfaced with explanations of this latest dispute. The undeniable role Ukraine played in the dispute was highlighted or downgraded in different accounts corresponding to the role Russia was attributed. Pavel Baev for

¹³⁴ Pirani, Stern & Yafimava, *op. cit.*, p. 16.

¹³⁵ *Ibid.*, 22.

¹³⁶ The outcome regarding RosUkrEnergo must be considered satisfactory for the Ukrainian leadership too, as one of the first goals of the new Timoshenko government in 2008 was to rid Ukraine of any intermediaries.

example, saw the dispute as a bid by Ukraine to provoke Russia and force its isolation from the European Union.¹³⁷ From a radically different perspective, Keith Smith blamed the dispute and the subsequent energy crisis in Central and Western Europe on Russia, as this dispute would have been the willing consequence of Russia's strategy to destabilize Ukraine with periodic price renegotiations.¹³⁸ Vladimir Milov, former deputy energy minister, also fully supported the version of Russian political and strategic motivations in an interview with RFE/RL; he stated that "*Gazprom was intentionally paving the way for a cutoff of gas (...) It is perfectly possible that this is a continuation of the same political line that we first saw last August during the conflict with Georgia*".¹³⁹ Robert E. Ebel also hinted at possible interests from the Russian side to provoke the crisis for strategic reasons,¹⁴⁰ even if he admitted the possibility of miscalculation from the Russian side regarding repercussions to European customers.¹⁴¹ However, Ebel's characterization of the dispute as informed by Russian desperation rather than confidence, something equally emphasized by Schleifer and Treisman¹⁴² and by Indra Overland,¹⁴³ put Russia in a different light. The comprehensive report by Pirani, Stern and Yafimava, which served as the basis for the previous section and provides to date the most thorough account of the crisis, acknowledges that in spite of the role played by Ukraine, Russia consciously escalated the crisis with measures out of proportion with Ukraine's appropriation of gas. Ukraine allegedly siphoned gas off for its use as technical gas, not putting European interests in the forefront and thus shunning its responsibility as a reliable supplier.¹⁴⁴ The authors move further from the previous theses and reject the speculation of a politically motivated dispute. However they still credit Russia with a manipulative role aimed at Europe. Russia would have escalated the dispute intentionally in order to convincingly put forward the argument of Ukrainian unreliability and open the door to Russian and European management of the Ukrainian transit network.¹⁴⁵ This is the case made also by Karen Smith Stegel, who explains that thus Russia would manage to

¹³⁷ Baev, Pavel: "Energy intrigues on the EU's Southern flank", *Problems of Post-Communism*, vol. 57, no. 3 (2010), p. 19.

¹³⁸ Smith (Keith), *op. cit.*

¹³⁹ Sokolov, Mikhail: "Gazprom harms Russian interests, Ukraine refuses to compromise: interview with Vladimir Milov", *RFE/RL*, 8 January 2009, at http://www.rferl.org/content/Interview_Gazprom_Harms_Russian_Interests_/1367968.html (Accessed on the 14th October 2013).

¹⁴⁰ Ebel, Robert E.: "The geopolitics of Russian energy: looking back, looking forward", Washington, D.C.: Center for Strategic and International Studies (2009), pp. 9-13.

¹⁴¹ *Ibid.*, p. 13.

¹⁴² Schleifer, Andrei and Treisman, Daniel: "Why Moscow says no: a question of Russian interests, not psychology", *Foreign Affairs*, vol. 90, no. 1 (Jan/Feb 2011), p. 127.

¹⁴³ Overland, Indra: "Natural gas and Russia-Turkmenistan relations", *Russian Analytical Digest*, no. 56 (2009), p. 11, at <https://edit.ethz.ch/fsk/publications/pdfs/RAD-56-9-13.pdf>.

¹⁴⁴ Pirani, Stern & Yafimava, *op. cit.*, pp. 33-34.

¹⁴⁵ *Ibid.*, pp. 35-36.

"convince" European consumers of the necessity of alternative transit projects bypassing Ukraine.¹⁴⁶ Simon Pirani strongly focuses on the underlying economic rationale for an increase of prices in supplies that had been subsidized until that date for countries such as Ukraine and on the effects both on Ukraine and Russia of the world financial crisis starting in 2008 (Adding in Russia's case the investment flight after the August 2008 War). He nevertheless leaves some space for political factors, when he points to the reduced threshold for tolerance since the "Orange" leaders came to power.¹⁴⁷ This is something equally mentioned as a possible cause for escalation by John Lough.¹⁴⁸ Jeronim Perovic also highlights the financial dimension and the fact that just before the crisis, Russia had to face an increase in prices for energy supplies from Central Asia. This author also suggests what would later be considered by Smith Stegel, namely that interests to portray Ukraine as an unreliable transit country in order to favor bypass pipeline projects and/or to gain a share in the Ukrainian energy transportation system lay behind the dispute.¹⁴⁹ Peter Rutland in an article published when the dispute was still unfolding, supported the economic explanation of the crisis pointing to the desperate financial situation of Ukraine and Russia after the global financial crisis.¹⁵⁰ As in the case of the energy crisis of 2006, a preliminary analysis points to strong economic reasons for the dispute to take place. As we have seen above, some authors suggest that there were political motivations behind the dispute that would explain the unprecedented harshness, but as Pirani, Stern and Yafimava point out, if that was the case, it is hard to see what were the exact motivations and how the pressure exerted could translate into political gains for Russian foreign policy,¹⁵¹ unless we imagine that Russia was consciously manipulating European opinion so as to blame Ukraine, thus looking for long-term solutions for the "Ukrainian mess" or fighting for short-term gains.

2. 4. Literature Review and the Energy Disputes

The general review on literature devoted to Russia's energy policy showed that the same usual cleavages that permeate the analysis of Russian foreign policy are present too. In certain respects this applies also to the discussion on energy disputes. As we could see above, the two main disputes between Russia and

¹⁴⁶ See for example: Smith Stegel, Karen: "Deconstructing the "energy weapon": Russia's threat to Europe as case study", *Energy Policy*, vol. 39, no. 10 (2011), p. 6509.

¹⁴⁷ Pirani, Simon: "How Post-Soviet transition and economic crises shaped the Russo-Ukrainian "gas wars"", paper, PEEER seminar, Governing Energy in Europe and Russia (3-4 September 2010), at <http://www2.warwick.ac.uk/fac/soc/csgr/peer/warwick/pirani-text.pdf>. and Pirani, "Am Tropf", *op. cit.*

¹⁴⁸ Lough, John: "Russia's energy diplomacy", Chatham House, *Briefing Paper* (May 2011), p. 9 at http://www.chathamhouse.org/sites/default/files/19352_0511bp_lough.pdf.

¹⁴⁹ Perovic, *op. cit.*, pp. 19-35.

¹⁵⁰ Rutland, Peter: "Gasmail", *Transitions Online*, 12 January 2009.

¹⁵¹ Pirani, Stern & Yafimava, *op. cit.*

Ukraine, those of January 2006 and January 2009, were the object of several analyses which differed in the degree of responsibility they accorded to either political or economic factors. However, whatever the degree, the fact is that the presence of the economic factor in most of the arguments is ubiquitous. A preliminary assessment of the disputes following the existing bibliography that has been devoted to them so far is that there are strong arguments, both because of the context and the timing of the crisis, to support the version of economy-induced disputes.

In any case, it is not until we have undertaken a thorough analysis of the three disputes that will be dealt with in this research, that we can draw clearer conclusions in that respect. That is what will be undertaken in chapters 6, 7 and 8, each of them devoted to a single dispute, January 2006, March 2008 and January 2009. The conclusions that will be drawn from there will serve the purpose described in the preceding chapter. Before that, the three following chapters, 3, 4 and 5 will deal with the energy sectors of Russia and Ukraine, the course of energy relations between Russia and Ukraine until 2005 and energy relations between Russia and its European customers.

PART II: BACKGROUND: ENERGY IN THE TRIANGLE RUSSIA-UKRAINE-EUROPEAN UNION (EU)

Chapter 3: Russia and Ukraine Energy Sectors

3. 1. The Soviet Energy Sector and its Energy Policy

The former Soviet Union was bound due to its (at least in terms of resources) privileged geographical position to be a resource rich country. The plentiful supply of oil and gas that the Soviet Union managed to develop was a good proof thereof and largely sustained the Soviet lackluster economic performance and prevented it from collapsing under unsustainable contradictions. Plenty did not only translate into cheap resources for the domestic economy, but in substantial exports and currency earnings that helped to close up the imbalance in both agricultural and developed industrial goods when oil prices skyrocketed in the 70s. When prices plummeted in the mid-80s, the Soviet Union felt the impact and that accelerated the economic crisis that eventually brought down the Soviet system.¹

The first contact of Russia with domestic production of oil came in the 19th Century from what would remain for a long time the main producer of oil in the Russian Empire: nowadays Azerbaijan. Kerosene made from oil extracted in the oil-rich region of Baku found a rich market in Northern Russia in need of artificial lighting.² As a sign of what would be Russian importance in the world market as one of the main producers until now at the time of writing, from 1898 to 1902 Russia managed to become the top producer of oil in the world.³ However, at the same time there appeared another fateful tendency which has been bedeviling Russia since then and which has translated into an inconstant production: the rapid exhaustion of existing wells,⁴ the slow introduction of technology to maximize extraction⁵ and the disregard of small wells not fit to produce an immediate substantial output.⁶ The crisis faced by the Baku wells at the start of the last century, where companies had not bothered to introduce enough modern techniques to maximize extraction was the first example, even if at the time the main harm came from

¹ For an interesting account on this thesis, see: Gaidar, Yegor (2007): *Collapse of an empire: lessons for modern Russia*, Washington, D.C., Brookings Institution Press.

² Goldman, Marshall (2008): *Petrostate: Putin, power, and the new Russia*, Oxford; New York, Oxford University Press, p. 18.

³ *Ibid.*, p. 21.

⁴ For a discussion of Soviet strategy in the face of bigger than expected depletion rates, and their preference for speeding up development of existing giant and supergiant fields, see: Gustafson, Thane (1989): *Crisis amid plenty: the politics of Soviet energy under Brezhnev and Gorbachev*, Princeton, Rand Corporation; Oxford, Princeton University Press, chapter 3, "Origins of the first Soviet oil crisis", pp. 63-91.

⁵ This is mentioned for example in Gustafson, "Crisis amid plenty", *op. cit.*, p. 100: the "oil surge" by Brezhnev from 1977 to 1980 consisting of redirecting resources to develop giant fields in West Siberia compounded the problem of declining productivity in the Ural and Volga regions, "slowing the introduction of new recovery techniques".

⁶ This was a natural consequence of over-exploitation of big fields and underinvestment for smaller ones. What had come to be called the "second-stage strategy" proved insufficient in the early 80s to offset the dreaded decline that was to hit in the mid-80s (see: Gustafson, "Crisis amid plenty", *op. cit.*, p. 104).

unrest related to the explosive social tensions in the late Czarist times.⁷ After the Revolution and with the advent of communism in what became the Soviet Union, new discoveries took place in the region of the Volga and the Urals. However, full development of these new fields would have to wait until after World War II. The region of Baku remained vital as a source of oil and became a major geostrategic objective during the war.⁸

Once the war was over and the Soviet Union recovered, those new deposits in the Volga and the Urals starting being exploited, with huge deposits in West Siberia soon to be added.⁹ In a shift similar both in pattern and chronology to that in Western Europe, the Soviet Union moved to substitute coal lignite, peat and shale for oil (mainly for electricity production and heating) due to the latter's cleanliness and greater efficiency.¹⁰ As seen in the paragraph above the Soviet extraction policy was short-term and favored immediate benefits from huge deposits until depleted.¹¹ With technologies that were already outdated, resources remained untapped. Luckily for the Soviet Union, the huge reserves still available in the whole territory allowed such a policy of exploitation with such technology. Thus, a combination of increased investments during the 60s and the undemanding conditions for exploitation of the new fields of the Urals/Volga reserves helped increase production dramatically.¹² To that came huge reserves of natural gas, which assumed an increasing share of internal consumption¹³ and freed volumes of oil previously consumed domestically for export.¹⁴ The industry of gas extraction was limited before World War II to oil production in the area of Baku, with natural gas associated to oil fields.¹⁵ Significant development came afterwards when production started in Ukraine. From there, new deposits were found in the region of Orenburg, in the Central Asian Republics and mostly, as with oil, in Western Siberia. Thanks to the added

⁷ Goldman, "Petrostate", *op. cit.*, pp. 22-24.

⁸ Other developed regions were actually located in the Caucasian region too, so the geostrategic importance could only increase.

⁹ Sclerotic bureaucracies and personal preferences though, account for a relative slowness in tapping the potential of oil and gas in substitution to coal (see: Dienes, Leslie and Shabad, Theodore (1979): *The Soviet energy system: resource use and policies*, Washington, V. H. Winstons & Sons; New York, Toronto, London & Sidney, p. 31; Gustafson, *op. cit.*, "Crisis amid plenty", p. 22).

¹⁰ *Ibid.*, p. 7.

¹¹ The over-reliance on the super-giant field of Samotlor in West Siberia is probably the best example (see: Dienes & Shabad, *op. cit.*, p. 58).

¹² Jentleson, Robert (1986): *Pipeline politics: East-West relations*, Ithaca; London, Cornell University, p. 83.

¹³ The explanation for natural gas to have reached a quarter of energy supply of thermal power stations as early as 1965 is technical rather than policy-based: the underdevelopment of gasification networks in the urban areas and the difficulties at the time for storing gas, led to a surplus that was then used for thermal production, with gas supply thus doubling from 1960 to 1965, and stabilizing since then as this surplus disappeared (see: Dienes & Shabad, *op. cit.*, pp. 35-36). A change in strategy in favor of gas as a supplier for domestic energy came after the "energy crisis" of the late 70s with oil production targets not being met; as prospects of gas extraction looked better, it was argued that gas should assume a bigger share in order to secure oil deposits (see: Gustafson, "crisis amid plenty", *op. cit.*, pp. 29-33).

¹⁴ Jentleson, *op. cit.*, p. 84; rather than substituting current oil already used in the Soviet economy, gas further substituted coal and thus helped the latter's reduction (Dienes & Shabad, *op. cit.*, p. 39) without impinging on oil's availability for export.

¹⁵ Dienes & Shabad, *op. cit.*, p. 69.

output of both oil and gas from these regions, the Soviet Union managed in the 70s to become an alternative to the OPEC. The timing favored the Soviet Union particularly, as it represented an alternative to higher prices imposed after the 1973 oil embargo. Still, fabulous volumes of gas in Western Siberia were belatedly developed. Development had to wait till the gas surge of the early 80s due to the previous belief in sufficient oil reserves which were cheaper to develop at the time than gas.¹⁶ More gas output translated into a clear increase in the share of gas in Soviet energy, going from 19% in 1970 to 26% a decade later and finally 33% in 1985.¹⁷

Crisis came when world oil prices fell in 1985 after the decision by Saudi Arabia to increase its production.¹⁸ That came with the beginning of Perestroika and worsened the ensuing economic crisis.¹⁹ However, it was the chaotic state of the economy brought by the Perestroika that tipped the energy sector into utter collapse, a situation that would continue in the turmoil of the first years of the Russian Federation. With the collapse of the Soviet Union, oil and gas production were to plummet dramatically in the first years of the Russian Federation. In Ukraine, gas output remained stable after a sustained collapse during the decade of the 80s. Both the Russian Federation and Ukraine would inherit some of the vexing problems derived from Soviet economic shortcomings. Among these problems, the high energy intensity ranked high. The problem of excessive energy intensity, already evident by the early 80s in the

¹⁶ When oil was to become more expensive as a result of decreasing marginal productivity, which demanded increased investment for similar yields, gas development became less expensive in relative terms (see: Gustafson, "crisis amid plenty", *op. cit.*, p. 143).

¹⁷ *Ibid.*, pp. 251-152; the increase continued in the last years of the USSR, as natural gas was used to reduce vast consumption of oil in the power sector instead of coal as was initially intended (see: *Ibid.*, p. 256). As inherited from that period, in the present day Russian Federation natural gas represents 56% of the energy primary consumption (see: EIA (2013): "Russia", p. 2, at <http://www.eia.gov/countries/analysisbriefs/Russia/russia.pdf> (Accessed on the 10th March 2014)).

¹⁸ As Thane Gustafson explained in his review to Dienes and Shabad (1979): *The Soviet Energy System*, the problem caused by the foreseen reduction in resource availability for the Soviet Union due to exhaustion of existing fields and insufficient discovery of new ones, stoked fears of seeing the Soviet Union turning into an importer from a big exporter, thus pushing world prices up or aggressively turning to the Persian Gulf (Gustafson, Thane: "The Soviet Energy Problem: What Policy Choices will it Require", *The Rand Corporation* (July 1980), p. 1). Similar concerns had worried analysts in the US in the decade of the 50s, when the Soviet Union had not recovered its pre-war oil production and was not expected to achieve it in the coming future; it was equally feared that an import-dependent Soviet Union would covet Middle-Eastern resources (see: Jentleson, *op. cit.*, p. 82). The real danger for the Soviet Union, though, was rather not be able to cover up for needed imports as a consequence of reduced reserves of currency (Gustafson, "The Soviet Energy Problem", *op. cit.*, p. 2;). As we now know, reports about impending resource scarcity in the Soviet Union (Echoing them: Stein, Jonathan B. (1983): *The Soviet bloc, energy, and western security*, Lexington, Massachusetts, Lexington Books, p. 2; Dienes & Shabad, *op. cit.*, p. 1.) were unjustified (see: Goldman, *op. cit.*, p. 50). Paradoxically, warnings by the CIA may account for the increase in investments in the energy industry in the late 70s when worse than expected depletion rates made their appearance (see: Gustafson, "Crisis amid plenty", *op. cit.*, p. 29). However, sinking oil prices in the mid-80s did put the Soviet Union in the face of a badly needed foreign currency scarcity.

¹⁹ Prices increased dramatically as a consequence of wages being raised, which translated into prices for all utilities, excepting oil which was still regulated; the oil industry had thus to face more unacceptable production costs without compensation (Gustafson, Thane (2012): *The wheel of fortune: the battle for oil and power in Russia*, Cambridge, Massachusetts, Belknap Press of Harvard University Press, p. 42). In addition to that, soon the government lacked investment resources to power up oil production and the sector was restricted from selling abroad; all this translated into dramatic falls in output (*Ibid.*, p. 48).

whole Eastern bloc,²⁰ was to persist in Russia and Ukraine while the former communist republics progressively improved their energy consumption in terms of efficiency during the transition to capitalism and their progressive integration into the European Union. As it will be seen later, this problem mostly concerns Ukraine, maybe less than due to its status as one of the most energy-intensive world consumers, but because of its energy dependence as opposite to the Russian Federation.

3. 2. The Russian Federation's Energy Sector and its Energy Policy

Russia's Energy Resources

The Russian Federation suffered a tremendous decline in output during the decade of the 90s. The decline affected both oil and gas and was related to the collapse in demand and production. Figures available at the US Energy Information Administration (EIA) show that if consumption in 1992 amounted to almost 4,500tb/day, it dipped to half of that in 1998 with 2,500tb/day.²¹ The production of oil in the Russian Federation since it became independent went from nearly 8,000tb/day in 1992 to barely above 6,000tb/day between 1996 and 1998, that is, an output reduction non-concomitant with that of consumption which left a much needed commodity available to maintain exports.²² In fact, if the Russian Federation managed to export almost 3,500tb/day in 1992, it actually exported more in the lowest point of the Russian economic collapse, with slightly above the former figure in 1998;²³ after having reached the bottom in 1994, oil exports started an upward trend that only stopped in 2007.²⁴

With regard to natural gas, a similar pattern happened in parallel with the collapse of the Russian economy. Natural gas consumption also witnessed a big decline, falling from 16,500bcf in 1992 to 12,250bcf in 1997.²⁵ Production fell from slightly over 22,500bcf in 1992 to less than 19,000bcf five years later in 1997.²⁶ As in the case of oil, the mismatch between production and consumption translated not only into sufficient volumes to maintain exports, but into bigger ones, as consumption fell much more

²⁰ This was dealt with by Jonathan B. Stein in 1983 (Stein, *op. cit.*, p. 1); as Dienes and Shabad explained in 1979, substantial decreases in energy intensity, that is, improvement of the ratio consumption/GNP growth were made through the substitution of coal by oil and gas and through the electrification of the country. As soon as this happened, the Soviet Union faced more difficulties in decreasing the energy intensity through saving measures that required additional investments and better technology (see: Dienes and Shabad, *op. cit.*, pp. 14-16).

²¹ See: EIA: "Russia: Overview data for Russia", at <http://www.eia.gov/countries/country-data.cfm?fips=rs#pet> (Accessed on the 10th March 2014).

²² *Ibid.*

²³ *Ibid.*

²⁴ *Ibid.*

²⁵ EIA: "Russia: Overview data for Russia", *op. cit.*

²⁶ *Ibid.*

dramatically than output. In the case of natural gas, hence, while the Russian Federation was exporting between 6,250bcf and 6,000bcf in 1992, the bottom was reached a year later with a volume between 5,750bcf and 5,500bcf.²⁷ Since that year there was a sustained upward trend so in 1996 exports were well above the volume reached at the dawn of independence with slightly above 6,750bcf.²⁸ After a fall the next year, a new upward trend continued until the year 2000 when the peak in exports was reached: 7,000bcf.²⁹

Oil and gas exports which during the 90s, as seen in the paragraph above, either maintained their volumes or even increased them, offered an important financial cushion to the Russian Federation during the critical years of the chaotic economic transition to capitalism. After the catastrophic situation of the economy was compounded by the financial crash of 1998,³⁰ the subsequent recovery came mostly due to the substantial role played by oil and gas exports. More than that, bigger volumes became ready in the coming years which proved crucial to sustain economic growth. These volumes expanded precisely when oil prices started increasing after the Asian and Russian crises of 1997 and 1998, becoming determinant for the stabilization of the country after the chaotic Yeltsin years. Thus, if total oil production remained barely above 6,000tb/day from 1996 to 1998, it had reached a staggering volume of nearly 10,000bt/day in 2007 while in 2012 the output had overcome that figure; with consumption moving only from 2,500bt/day to nearly 3,250bt/day in 2012, volumes for export grew substantially.³¹ Output of natural gas also grew even if it did not come close to such increase rates as in the oil industry: from less than 19,000bcf in 1997, the Russian Federation was producing around 21,750bcf in 2006, with a transitory fall to around 19,250bcf in 2009 due to the financial crisis of 2008, only to bounce back and reach its peak two years later with 22,250bcf.³² Natural gas production, mostly geared towards internal consumption (with Gazprom's exports subsidizing prices), has proved very sensitive to internal consumption. This can be seen in the effect that the 2008 crisis had, which similarly affected both production and consumption. The Russian Federation has not been able to offset increasing internal consumption which would have freed volumes of gas for exports in order to reproduce the success registered by the oil industry.³³

²⁷ *Ibid.*

²⁸ *Ibid.*

²⁹ *Ibid.*

³⁰ As explained by Thane Gustafson in his masterful account of the energy sector in Russia since independence, the spiral of inflation only got worse with the economic policies taken in 1992 (Gustafson, "the wheel of fortune", *op. cit.*, p. 53), with the disastrous breaking into pieces of the oil industry (*Ibid.*, pp. 54-57) and the dislocation of the former Soviet industry, so the oil sector ceased receiving supplies from Azerbaijan and Ukraine (*Ibid.*, p. 60).

³¹ EIA: "Russia: Overview data for Russia", *op. cit.*

³² *Ibid.*

³³ *Ibid.*

At the time of writing, the great challenge for the Russian gas industry remains to maintain the level of production for the coming years.³⁴ As Jonathan Stern pointed out in 2005, either increasing or at least maintaining production in the face of the depletion rate of big fields such as Urengoy, Yamburg, Medvezhe and Orenburg comes with the exploitation of new fields in the Yamal era and the Shtokman fields in the Barents Sea, which are more difficult to exploit.³⁵ A particular quandary is posed by the offshore field of Shtokman, requiring foreign assistance but then stumbling on Russia's reticence to allow foreign capital, this being a reason for the constant delay of the project.³⁶

Internal Energy Sector

The energy gas sector in the Russian Federation is much less plural than that of oil, with Gazprom being both the main producer and the owner of the transport and distribution networks.³⁷ The Ministry of Natural Gas did not have any competence in distribution during the Soviet times. However, the situation was such during the 90s, that many municipal distribution companies, being unable to pay their debts to Gazprom, swapped debts for equity, so the monopoly came to control the sector.³⁸

Domestic prices for natural gas in the Russian Federation are regulated, and that, contrary to what happens in Ukraine, includes industrial consumers. Gazprom demands that consumers bid for quotas in beforehand, with out of quota gas paid at non-regulated prices and under-consumption penalized by swaps of non-regulated prices in moments of demand. As the OECD economic survey from 2004 (quoted by Jonathan Stern) pointed out, this system is very opaque and some consumers do not receive supplies as

³⁴ The oil industry, which managed to increase proved reserves to 80bbl in 2012 from less than 50 up to 2002 (see: *Ibid.*). However, the natural gas industry remains still below the level of 1,700Tcf up to 2002, having peaked at 1,687.5Tcf in 2012 after slightly bouncing up from a previous plateau of 1,680Tcf.

³⁵ Stern, Jonathan (2005): *The future of Russian gas and Gazprom*, Oxford, Oxford University Press, p. 11. The huge difference that the exploitation of new fields would make for Gazprom's output can be seen in: Noël, Pierre: "Beyond dependence: how to deal with Russian gas", European Council on Foreign Relations, *Policy Brief* (7 November 2008), Figure 6, "Gazprom's gas output (2000-2035)", p. 6, at http://ecfr.eu/page/-/ECFR-09-BEYOND_DEPENDENCE-HOW_TO_DEAL_WITH_RUSSIAN_GAS.pdf.

³⁶ A consortium was formed in 1995 between Total (France), Conoco (USA), Hydro (Norway) and Fortum (Finland) with Rosshelf (Gazprom), the latter owning 50% plus one shares; although a production sharing agreement was approved in 2000, the 1996 framework expired and the licence was transferred to Rosneft Purneftegaz (50%) and Rosshelf (50%). With the former selling its shares in 2005, Gazprom remained the sole owner (see: Stern, "The Future of Russian Gas and Gazprom", *op. cit.*, p. 17). The same state of indeterminacy prevailed regarding the means of transportation, whether pipeline developments to Europe or possible LNG exports to the US (*Ibid.*, pp. 17-18). Neither of these materialized.

³⁷ This is explained by Thane Gustafson as a result of the skilful management of Viktor Chernomirdin and the lucky turn of Prime Minister Yegor Gaidar in 1992 who overruled those who wanted to split the Ministry of Gas, from where Gazprom stemmed (see: *The Wheel of fortune*, *op. cit.*, pp. 69-71). Gazprom remained an essential factor to ease the catastrophic economic situation of the Russian Federation, ensuring much needed supply of domestically consumed gas.

³⁸ Distribution companies ended up concentrated in 60 regional companies (55 of them controlled by Gazprom) (Stern, "The Future of Russian Gas and Gazprom", *op. cit.*, pp. 38-39).

contracted, having therefore been forced to purchase additional gas at higher prices.³⁹ The downside for Gazprom in this system is that prices are so regulated that the company sells at a loss in the domestic market.⁴⁰ Aware of this problem, the decision was taken in November 2006 and a timetable agreed in May 2007, through the Decree No. 333 "On Improving State Regulation of Gas Prices", to impose a gradual increase in wholesale domestic gas prices (for industry, power and district heating sectors). The objective was to raise them to parity with Gazprom's European exports' netback prices.⁴¹ If initially set to 2011, the timetable was pushed to 2014.⁴² The Decree No. 1205 from 31 December 2010 established a transitory period from 2011 to 2015 which allowed yearly increases in prices of 15%, so by 2015, no difference remained between domestic and export prices.⁴³ Prices rose from 2003 to 2010 from US\$24.7tcm to US\$82.60tcm for wholesale prices and US\$16.3tcm to US\$63.43tcm for domestic consumers.⁴⁴ The increase from 2006 to 2012 was US\$34tcm to US\$90tcm, an increase of 2.6 times in current prices.⁴⁵ In a new revision, the "Outlook for Social and Economic Development of the Russian Federation for 2013 and the Planned Period of 2013-2015" approved further price increases until 2015, which however, were later limited to 5% only.⁴⁶ Gains made by Gazprom were partly offset by inflation.⁴⁷ In fact, if we compare industry prices in Russia to IEA member countries, in Russia they range slightly above US\$10MWh, while most of IEA members' prices range between US\$40MWh and US\$50MWh.⁴⁸

Regarding losses due to non-payments, the situation, which was catastrophic during the 90s, improved progressively so Gazprom could receive most of its due payments as the decade of the 00s advanced. By 2003, as a consequence of previous non-payments the company still had around US\$1 of non-recovered debts.⁴⁹ Another element that impinges on Gazprom's finances is the importance for the government to tax one of the main Russian sources of foreign currency. In fact, by 2003, Gazprom

³⁹ *Ibid.*, pp. 40-41.

⁴⁰ *Ibid.*, p. 43. According to Jonathan Stern's calculations, not even industrial prices, higher than those in the residential sector, were profitable (see: *Ibid.*, p. 48).

⁴¹ IEA, "Russia 2014", Energy policies beyond IEA countries, p. 106.

⁴² Pirani, Simon: "Elusive potential: natural gas consumption in the CIS and the quest for efficiency", Oxford Institute for Energy Studies (July 2011), Table 6: "Gas for the heat and power sector: comparisons", p. 25, at <http://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/07/NG-531.pdf>.

⁴³ IEA, "Russia 2014", *op. cit.*, p. 107.

⁴⁴ Pirani, "Elusive potential", *op. cit.*, Table 10: "Russian and Western CIS gas sales and import prices, 2003-2011", p. 26.

⁴⁵ IEA, "Russia 2014", *op. cit.*, p. 107.

⁴⁶ *Ibid.*, *Idem.*

⁴⁷ *Ibid.*, *Idem.*

⁴⁸ *Ibid.*, Figure 4.7, p. 108.

⁴⁹ Stern, "The future of Russian gas and Gazprom", *op. cit.*, p. 50.

represented 20% of all federal tax receipts.⁵⁰ The prices for electricity also affect gas consumption, as it is one of the main items for power generation.⁵¹

In spite of the initial huge problems Russia had to face, its fate changed radically (at least regarding energy) and that right after the country had plunged into a new crisis due to the economic financial crisis of 1998. As already mentioned above, after nose-diving in the wake of the Asian financial crisis of one year before,⁵² oil prices started to recover from 1999 in a trend which was to last until the global financial meltdown that began in 2008. As a result of the global economy bouncing back, oil prices had doubled by the year 2000 compared to two years ago with US\$33 per barrel⁵³ and were poised for a near record, achieved in January 2008, when prices reached US\$100 per barrel.⁵⁴ This situation encouraged imports of top technology from Western countries which helped Russia increase its output. Thus Russia managed to become again the world's top oil producer in the first decade of the current century. This economic reality came together when it encountered two positive political turns, which were Europe's desire to turn away from the troublesome Middle East as main source of imports⁵⁵ and the EU's policy of increasing the share of natural gas in the energy mix of the country for environmental concerns. Russia's gas booming production was in the right place at the right moment.

The arrival of Putin as President of the Russian Federation in the elections of 2000 (he had become Prime Minister in 1999 and then acting President after Boris Yeltsin's resignation) coincided with this positive conjuncture. Putin's era also signaled a process of recentralization of the energy sector after the rough decade of the 90s and the chaotic process of privatization. This had a clear reflection in the case of Yukos, Mikhail Khodorkovsky's company. Vladimir Putin's focus on competitive companies that could play a defining role in the international arena and the need to remain a superpower as Russia was intended to be, translated into state control or at least reining in of oligarchs owning companies responsible for Russia's vast commodities.⁵⁶ In any case, that translated into more certain capital in the energy sector. As Marshall Goldman exposes, from 2000 to 2007, the Russian state managed to increase

⁵⁰ *Ibid.*, p. 56.

⁵¹ With data for 2008: gas consumption represented a token share of 0.6% in electricity plants: however, it represents a share of 41.5% in CHP (Combined Heat and Power) plants (see: Pirani, "Elusive potential", *op. cit.*, Table 6: "Gas for the heat and power sector: Comparisons", p. 10).

⁵² In fact, the economic crisis in South-East Asia was a trigger to Russia's own crisis one year later, as the fall in commodities prices, which thus affected oil prices, translated into lesser currency revenues for the Russian economy (see: Goldman, *op. cit.*, p. 75). Oil prices fell from US\$26 per barrel in 1996 to less than US\$15 per barrel two years later (see: *Ibid.*, *Idem.*).

⁵³ *Ibid.*, *Idem.*

⁵⁴ *Ibid.*, p. 79.

⁵⁵ *Ibid.*, p. 81.

⁵⁶ For Vladimir Putin's thought in this respect, see: Balzer, Harley: "The Putin thesis and Russian energy policy", *Post-Soviet Affairs*, vol. 21, no. 3 (2005), pp. 210-25.

its shares in the oil sector from 17% to about 50%.⁵⁷ The most striking measure taken in the oil sector was the imprisonment of Mikhail Khodorkovsky and the seizure of its company, Yukos by Rosneft.⁵⁸ The reaction to Khodorkovsky's economic assets had a large political motivation,⁵⁹ but the fact that he pretended to lay private-owned pipelines in avoidance of the state monopoly Transneft should not be overlooked.⁶⁰

In the gas sector, the state's policy easily translated into changing the balance in favor of the state in the company Gazprom, where it had managed to retain between 35% and 40% of its capital. The chairman of Gazprom, Viktor Chernomirdin was removed in 2000 as was its CEO, Rem Viakhirev one year later, to be substituted by the faithful Alexei Miller who has retained his post to date. The first step after this was to rein in Itera, a company headed by Igor Makarov and which had been used for the personal benefit of Gazprom's own executives. As the largest Russian natural gas company after Gazprom, Itera was its main competitor and had taken a significant position in the CIS space (more on this in chapter 4). Itera was simply denied most of its contracts and as a consequence lost its importance.⁶¹ A proof of the renewed power from Gazprom can be found in how it managed to take natural gas development in the field of Kovykta from its competitor TNK-BP. The Russian energy policy soon started facing the challenge of keeping up with a sustained production that could maintain or increase its exports in order to offset a predicted increase of internal consumption. In 2008 Pierre Noël showed graphs (based on Gazprom and BP statistics) calculating the increase in output to 2035: from gas output at the time of writing around 550bcm, in the best case scenario Gazprom would be able to increase it to 630bcm.⁶² At that time, predictions were that Gazprom would not be able to fill the gap of a declining production in Europe,⁶³ something that increasing Russian internal consumption and failure to invest to

⁵⁷ Goldman, *op. cit.*, p. 99.

⁵⁸ *Ibid.*, pp. 120-123.

⁵⁹ *Ibid.*, pp. 105-120.

⁶⁰ Michael Fredholm argues that Yukos having proposed the construction of two private oil pipelines, one in the 90s from Angarsk to Daqing (China), and the second, in 2002, from West Siberia to the port of Murmansk, it challenged the state's preeminence in energy policy (see: Fredholm, Michael: "The Russian energy policy and energy strategy: pipeline diplomacy or mutual dependence?", *The Conflict Studies Research Centre* (Sept. 2005), p. 12, at [www.defac.ac.uk/colleges/csrc/document-listings/russian/05\(41\)-MF.pdf](http://www.defac.ac.uk/colleges/csrc/document-listings/russian/05(41)-MF.pdf); for a detailed outline of Yukos project in East Siberia and the fight with the Russian government, see: Nodari, Simonia: "Russian energy policy in the East Siberia and the Far East", *The Baker Institute Energy Forum*, Rice university, *The Energy Dimension in Russian Global Strategy* (Oct. 2004), at http://www.rice.edu/energy/publications/docs/PEC_SimoniaFinal_10_2004.pdf.

⁶¹ Goldman, *op. cit.*, p. 105; this is the line that Martha Brill Olcott subscribes to when she states that the Russian government did not need to resort to such harsh measures as were taken (Olcott, Martha Brill: "The Energy dimension in Russian global strategy, Vladimir Putin and the geopolitics of oil", James E. Baker Institute, *Baker Institute Energy Forum* (2004), p. 13 at http://large.stanford.edu/publications/power/references/baker/studies/pec/docs/PEC_Olcott_10_2004.pdf.

⁶² Noël, *op. cit.*, p. 6.

⁶³ *Ibid.*, *Idem.*

guarantee a best case scenario could make even worse.⁶⁴ According to IEA data from 2012, the Russian Federation had produced 656bcm,⁶⁵ down from 677bcm in 2011,⁶⁶ but still more than 637bcm in 2010.⁶⁷ Now that the shale revolution in the US has left many former LNG supplies available for consumption in Europe, it is thought that the production gap in this region can be easily made up. However, the LNG glut is expected to be short-lived, only until the market adapts to the recently gained US energy independence. Besides that, unless a shale revolution also changes the whole picture in Europe (which is unlikely), energy dependence on LNG can hardly translate into cheaper prices than what Gazprom offers.⁶⁸ With Russia retaining price competitiveness, it is crucial that it increases its output as much as possible and increases efficiency at home to curb domestic consumption. The fact is that during the last years, the Russian gas market has become less Gazprom-centric with an increasing role for the state company Rosneft and mainly the independent producer Novatek, something which could translate in increased Russian gas output.⁶⁹

Energy Efficiency

The problem of efficiency with which the previous paragraph closes made its appearance already in The Soviet Union. During the oil shocks of the 70s the West coped with the new challenge through increased efficiency which would translate itself into reduced consumption. None of it happened in the Soviet

⁶⁴ With a total gas output of 510bcm in 2011, Gazprom's production declined from previous years (see: "Russia's natural gas dilemma", *Euractiv*, 11 April 2012, at <http://www.euractiv.com/energy/russias-natural-gas-dilemma-analysis-512092> (Accessed on the 4th March 2014). However, much of it is related to a consumption decline in Europe due to the ongoing economic crisis, whereas sharp decline at the onset of the crisis was caused by slowdown in the Russian economy.

⁶⁵ IEA (2013): "Key World Energy Statistics", p. 13, at <http://www.iea.org/publications/freepublications/publication/KeyWorld2013.pdf> (Accessed on the 6th March 2014).

⁶⁶ IEA (2012): "Key World Energy Statistics", p. 13, at <https://www.iea.org/publications/freepublications/publication/kwes.pdf> (Accessed on the 6th March 2014).

⁶⁷ IEA (2011): "Key World Energy Statistics", p. 13, at https://www.iea.org/publications/freepublications/publication/key_world_energy_stats-1.pdf (Accessed on the 6th March 2014).

⁶⁸ With natural gas prices indexed to oil for a long time ahead in Asia, hub-based natural gas prices for LNG in Europe will not be competitive enough for producers to translate into prices that could match those much cheaper offered by Gazprom. In the best case, LNG from the US would just be slightly over current prices in Europe (see: Boersma, Tim and Greving, Geert: "Why Russian natural gas will dominate European markets", Brookings (24 February 2014), at <http://www.brookings.edu/research/opinions/2014/02/24-russian-natural-gas-european-markets-boersma-greving> (Accessed on the 10th March 2014). With this perspective, it is doubtful that prices will become competitive in the short-medium term (see: Harris, Nigel: "Should natural gas prices in Europe and Asia be de-linked from oil?", The Oxford-Princeton Programme (12 March 2013), at <http://www.oxfordprinceton.com/news/latest-news/338-should-natural-gas-prices-in-europe-and-asia-be-de-linked-from-oil.html> (Accessed on the 11th March 2014). Besides that, the question remains whether shale gas reserves will be able to be sustained for a long period in the US.

⁶⁹ From 2008 to 2010, Russian natural gas production increased from 678bcm to 717bcm, with the Far East and Eastern Siberia, whose production does not go to Europe, representing only 10bcm of the added 39bcm in output (see: Locatelli, Catherine and Rossiaud, Sylvain: "Russia/CIS gas", Polinares, *Working Paper*, no. 71 (December 2012), p. 2, at http://www.polinares.eu/docs/d5-1/polinares_wp5_chapter5_1.pdf. Novatek for example increased its output from 29bcm in 2007 to 54bcm in 2011 (*Ibid.*, p. 4).

Union,⁷⁰ the fact that it was one of the largest producing countries probably being at least a partial explanation for this.⁷¹ Gas thought to be in greater supply than oil was used to offset feared oil depletion instead. This turned the economy of the Russian Federation into a highly gasified one and where incentives to increase efficiency were scarce.

The historic evolution of energy intensity, in a similar way to how it happened in Ukraine (see below) was determined after the fall of the Soviet Union by the reduction of energy intensive industries, but the average reduction of 3.4% per year was lower than the average of the rest of CIS countries. The potential for further reduction from this side seems to have become spent by 2006.⁷² One of the incentives in the last years for postponing the resolution of the dilemma posed by insufficient energy efficiency has been caused by the existence of gas supplies from Central Asia that could complement Russian production. The potential to reduce high energy intensity in Russia has to be qualified as it is related in 3/4 to temperature, land mass, and industry structure.⁷³

As can be seen in the latest report of the IEA devoted to the Russian energy sector, Russia's energy intensity has been significantly reduced since independence: if the TPES/GDP coefficient was 0.47 in 1990 and increased to a peak above 0.55, in 2012 it had fallen to 0.35,⁷⁴ declining by 23.6% since 2002, even if a slightly upward trend resumed in 2008, the year which marked the lowest coefficient.⁷⁵ The Key World Energy Statistics by the International Energy Agency (IEA) from 2012 showed a sharp reduction in 2011 (since 2005, the energy intensity per GDP (PPP) represented a coefficient of 0.42)⁷⁶ that Russia's energy intensity lowered to 0.35 in 2011.⁷⁷ This probably results from a statistical correction which concentrated in one single year past years' improvements which had gone unreported to date. As

⁷⁰ Gustafson, "Crisis amid plenty", *op. cit.*, p. 9.

⁷¹ In fact, as Thane Gustafson highlights, external shocks worked in reverse in the Soviet Union, a producer country, compared to Western consumers: it is when oil prices fell in 1985 and the Soviet Union was faced with a grave reduction of hard-currency that measures were first introduced, as reduced consumption would free badly needed exports (see: *Ibid.*, *Idem*).

⁷² "Energy efficiency in Russia: untapped potential", International Finance Corporation (IFC) (2008), p. 7, at <http://www.ifc.org/wps/wcm/connect/de1e58804aababd79797d79e0dc67fc6/IFC+EE+in+Russia+Untapped+Potential.pdf?MOD=AJPERES> (Accessed on the 5th March 2014). According to the report from the IFC, by 2006 the Russian industry had achieved full capacity utilization (*Ibid.*, *Idem*); with 2.5% of average in the 90s and 5% from 2000 to 2007, the IEA considers that in the latter period GDP growth mostly accounts for this achievement (which along with the factor of deindustrialization, cannot be attributed to any specific efficiency measures (see: IEA (2011): "Development of energy efficiency indicators in Russia", p. 7, at

https://www.iea.org/publications/freepublications/publication/Russia_En_Eff_Ind.pdf (Accessed on the 5th March 2014). As Simon Pirani mentions, some studies have suggested that in the period from 2005 to 2007 some gains may respond to efficiency policies (see: Pirani, "Elusive potential", *op. cit.*, p. 22).

⁷³ "Energy efficiency in Russia", *op. cit.*, p. 30 (see Figure 10, "Weight of various factors in determining Russia's energy intensity").

⁷⁴ IEA, "Russia 2014", *op. cit.*, Figure 2.5, p. 26.

⁷⁵ *Ibid.*, p. 26.

⁷⁶ "Energy efficiency in Russia", *op. cit.*, pp. 27-28.

⁷⁷ IEA (2012): "Key World Energy Statistics", *op. cit.*, p. 55.

the global economic crisis according to some reports would have provoked an increase in energy intensity instead,⁷⁸ and gas consumption according to the Oxford Energy Institute had already not only recovered but even overcome consumption previous to the crisis by 2010 (based on Russian Energy Ministry data, while statistics from Gazprom point to just a recovery),⁷⁹ this matches the trend by the IEA Russia report.

The truth is that this reduction in TPES/GDP is not mainly derived from increased general efficiency of the Russian economy. This reduction was due, to a large extent, to increased energy prices. This increased revenues for equivalent volumes of hydrocarbons, so the GDP increased in value without increased energy outputs.⁸⁰ The energy required to produce a unit of GDP remains two and a half times more expensive than the IEA average, and twice as much as in Canada, a country sharing a similar climate.⁸¹

Regarding natural gas in particular, our focus in this research, namely, the perverse effect of pricing in the Russian Federation since independence must be highlighted, as it has made matters worse as far as gas consumption is concerned. As seen in the section above, gas prices have been historically highly regulated in the Russian Federation. The effect was that many customers, seeing gas priced more cheaply than coal and oil, switched to this source of energy.⁸² This has only made the need to resolve the efficiency problem more pressing. President Dmitry Medvedev approved an action plan to halve Russia's energy intensity by 2020 and a Russian Energy Agency (REA) was established. Russia's energy policy, at the time of writing, is determined by the Energy Strategy to 2030 approved in 2009 and the Decree No. 512 approved in 2013 and in process of being updated in 2014, "On Energy Efficiency and the Development of Energy".⁸³ The overall efficiency goal calls a reduction in energy intensity by 40% in 2020, taking 2007 as a benchmark,⁸⁴ based on the June 2008 Presidential Decree No. 889 "On Measures

⁷⁸ See for example: "Russia struggles to curb energy waste", *New York Times*, 20 March 2012, at <http://www.nytimes.com/2012/03/21/business/global/Russia-Struggles-to-Curb-Energy-Waste.html?pagewanted=> (Accessed on the 6th March 2014). If decline centered on low-consuming industries, that could easily explain this phenomenon. As for energy intensity in 2010, when figures were recovering, Simon Pirani points to the fact that temperatures were abnormally high, which should have pushed up consumption beyond normal levels (see: Pirani, "Elusive potential", *op. cit.*, p. 16).

⁷⁹ Pirani, "Elusive potential", *op. cit.*, Table 9 and Figure 2, p. 16. Simon Pirani points that actually 2010 consumption levels, when compared to 2009 on a monthly basis, show that whereas consumption outpaces 2009 during the winter months, it reaches the same level in Autumn, something which could point to the temperature as the defining factor. 2010's consumption also outpaces that in the previous year from late Spring to early Autumn (see: *Ibid.*, pp. 16-17); as for also unusually hot temperatures in Summer, they could explain an increased electrical consumption.

⁸⁰ IEA, "Russia 2014", *op. cit.*, p. 31.

⁸¹ *Ibid.*, *Ibid.*

⁸² Stern, "The Future of Russian Gas and Gazprom", *op. cit.*, p. 48.

⁸³ IEA, "Russia 2014", *op. cit.*, p. 23.

⁸⁴ *Ibid.*, *Idem.*

to Raise Energy Efficiency and Foster Environmental Stability in Russia's Economy".⁸⁵ It remains to be seen whether Russia is on track to achieve goal.

According to a study by the International Finance Corporation (IFC), dependent on the World Bank of 2008, the Russian Federation has indeed the potential to reduce consumption by a 45% taking figures from 2005 as a reference.⁸⁶ Natural gas consumption's breakdown by sector is the following: 40% electricity, 14% heat plants, 13% industry, 11% households, 6% raw materials, 10% technological needs and losses and finally 6% in other sectors.⁸⁷ As for the efficiency potential, this is, according to the IFC report, mainly concentrated in the following sectors: buildings (with heating as the major item),⁸⁸ manufacturing and electricity generation and delivery, heat generation, transport, fuel production and transformation.⁸⁹ Significantly, in Russia natural gas represents 53.3% (referenced on 2008 data) of its total primary energy supply, compared to only 25.2% in the EU.⁹⁰ Translated into savings of gas, additional volumes could be freed for export and for earnings of international currency. Accordingly, this might amount to as much as 240bcm.⁹¹ If Gazprom for example in 2012 sold 466.8 bcm (217.1bcm were sold abroad),⁹² the change of applying the efficiency measures advised in the report becomes manifest. Russia could easily assume an expansion of consumption at home while securing added exports abroad, even in the face of reduced output.⁹³

⁸⁵ *Ibid.*, p. 24.

⁸⁶ "Energy efficiency in Russia", *op. cit.*, p. 5.

⁸⁷ IEA, "Russia 2014", *op. cit.*, Figure 5.6, p. 99.

⁸⁸ As an example *The Moscow Times* reported in late 2013 that the housing sector in some cases spent twice as many resources for heating than housing in regions of Europe and the US where a similar climate prevailed ("Russian homes using up to 100% more energy than in U.S. and Europe", *The Moscow Times*, 26 November 2013, at <http://www.themoscowtimes.com/transport%20&%20logistics/article/russian-homes-using-up-to-100-more-energy-than-in-us-and-europe/490160.html> (Accessed on the 5th March 2014).

⁸⁹ "Energy efficiency in Russia", *op. cit.*, pp. 39, 46, 51, 56, 58, 63.

⁹⁰ Pirani, "Elusive Potential", *op. cit.*, pp. 8-9.

⁹¹ "Energy efficiency in Russia", *op. cit.*, p. 5, 8, 38. Besides this, savings would also release additional amounts of oil and carbon.

⁹² "Gazprom in Figures 2008—2012", Gazprom, *Factbook* (2013), pp. 63-64, at

<http://www.gazprom.com/f/posts/55/477129/gazprom-reference-figures-2008-2012-eng.pdf> (Accessed on the 5th March 2014).

⁹³ Besides that, energy security (understood as human security) would be improved for the population, as electricity and supply restrictions during winter months would cease ("Energy efficiency in Russia", *op. cit.*, p. 16). However, Simon Pirani pointed in 2011 (see: Pirani, "Elusive potential", *op. cit.*, p. 2) that he expected consumption in the CIS to be more limited than thought, so expanded output would automatically translate into increased exports.

3. 3. Ukraine's Energy Sector and its Energy Policy

Ukraine's Energy Resources

Ukraine was far from being poorly endowed in terms of energy resources. However, the general picture in energy development is one of insufficiently exploited potential, as both the Black Sea region and the Sea of Azov are home to rich fields of both gas and oil. The reason for this under-exploitation is that the Soviet Union favored cheaper fields (in terms of costs of exploitation) in the Volga region and in West Siberia, which explains the reason why in 1996 Ukraine only consumed 13% and 17% of domestic oil and gas respectively, with Russia being the main supplier.⁹⁴ However, Ukraine had some decades ago a very high output of domestic gas until the decade of the 80s. If extraction had started in the Carpathian region in West Ukraine after its inclusion into the Soviet Union in 1939,⁹⁵ it was not until 1955 when production surged dramatically. The exploitation of the huge Shebelinka field (similar to fields in the other big producing regions) in Eastern Ukraine made Ukraine for a time the main production region in the USSR.⁹⁶ Output reached a peak of 68.7bcm in 1975 which fell to 53.8bcm in 1980.⁹⁷ However the classic pattern of gas depletion soon doomed the Shebelinka field and Ukraine suffered a huge loss of production during the decade of the 80s.⁹⁸ Output remained stable during the 90s, ranging from 20.9bcm in 1992 and 17.9bcm in 2000⁹⁹ and has since then slightly recovered to stabilize again around 20bcm by 2005.¹⁰⁰ This meant that Ukraine ended up at the time of its independence with a very high rate of energy dependence: 89% of its oil needs were covered by imports,¹⁰¹ as well as importing around 60% of its gas from Russia.¹⁰²

⁹⁴ Balmaceda, Margarita M.: "Gas, oil and the linkages between domestic and foreign policies: the case of Ukraine", *Europe-Asia Studies*, vol. 50, no. 2 (1998), pp. 258-259.

⁹⁵ Dienes & Shabad, *op. cit.*, p. 69.

⁹⁶ *Ibid.*, p. 75.

⁹⁷ *Ibid.*, pp. 70-71; this sudden fall in production in the late 70s (see: *Ibid.*, p. 76) prefigured the huge rates of depletion that would bring production down dramatically in the next decade.

⁹⁸ A graphical illustration of the dimension of the dramatic fall can be seen in: IHS CERA: "Natural gas and Ukraine's energy future", Ministry of Energy and Coal Industry of Ukraine (February 2012), Figure 3-1, p. 3-1 (33), at <http://s05.static-shell.com/content/dam/shell-new/local/country/zaf/downloads/pdf/research-reports/Ukraine-Policy-Dialogue-report.pdf>, (Accessed on the 4th February 2014).

⁹⁹ IEA (2006): "Ukraine: energy policy review", p. 173, Table 5-4, at

<http://www.iea.org/publications/freepublications/publication/ukraine2006.pdf> (Accessed on the 30th January 2014).

¹⁰⁰ *Ibid.*, *Idem.*

¹⁰¹ Balmaceda, Margarita (2008): *Energy dependency, politics and corruption in the former Soviet Union : Russia's power, oligarchs' profits and Ukraine's missing energy policy, 1995-2006*, London; New York, Routledge, p. 45.

¹⁰² Puglisi, Rosaria: "Clashing agendas? Economic interests, elite coalitions and prospects for co-operation between Russia and Ukraine", *Europe-Asia Studies*, vol. 55, no. 6 (2003), p. 829. Ukraine is richly endowed with coal; although plans made in the 70s to increase the share of coal in the power industry failed; the objective was to substitute oil (mazut) for coal, as there were concerns regarding the former's reserves, but in fact the share of oil in that sector went up from nearly 30% in the 70s to 35.7%

As surprising as this might seem, the situation in Ukraine after independence has not changed substantially in spite of becoming highly dependent on an external actor, the Russian Federation. Failure to agree on a border demarcation in the Azov Sea surely affected any chances to develop rich resources in the area.¹⁰³ However, the main obstacle stemmed from the complex energy relations with producers within the CIS. As a transit country, Ukraine was entitled to transit tariffs that ensured free supplies. At the same time danger of supply disruptions further West ensured that gas disputes often translated into Gazprom accepting subsidized prices. In addition, Ukraine could for a long time import gas from Central Asian, mainly Turkmenistan (See chapter 4). Finally, if that was not enough, companies could often translate energy debts to the state budget.¹⁰⁴ Incentives thus barely existed to exploit domestic resources. In any case, the fact is that Ukraine is still endowed with very important resources in hydrocarbons that could boost production and lessen its energy dependence from other producers in the CIS. With an estimate of 5.37Tcm of conventional gas, more than other countries as UK, the Netherlands and Norway,¹⁰⁵ Ukraine has still a big potential to tap, without counting reserves in unconventional gas, which some estimates calculate as high as 11.5Tcm.¹⁰⁶ If Ukraine introduced new recovery techniques (3D seismic, horizontal drilling, multilateral completions, hydraulic fracturing, compression and nitrogen injection) to maximize output of existing fields and developed the so called "tight reservoirs" not exploitable before,¹⁰⁷ production could be boosted in 2035 to around 50bcm per year, instead of the slightly more than 10bcm that Ukraine might be producing from its depleting existing fields under current exploitation.¹⁰⁸ If an optimistic scenario of exploitation of unconventional gas is considered, Ukraine might be producing around 70bcm of gas instead.¹⁰⁹ That could turn Ukraine not only into an energy independent country, but it could even transform it into a gas exporter, especially if these rates of exploitation were coupled with a better management of its consumption and if energy efficiency was improved. The biggest challenge in order to meet the figures suggested in the report by IHS CERA is to maintain investments of around

in 1980 in the whole of the USSR, while in Ukraine the results were even worse: the share simply doubled (see: Gustafson, "Crisis amid plenty", *op. cit.*, p. 255).

¹⁰³ Balmaceda, "Gas, oil and the linkages", *op. cit.*, p. 261.

¹⁰⁴ Balmaceda, "Energy dependency, politics and corruption", *op. cit.*

¹⁰⁵ According by a report from IHS CERA dated from 2012, this favorably compares to mature areas of production of both the UK and the Netherlands with 2.6Tcm and Norway with 3Tcm (see: IHS CERA, *op. cit.*, p. 1-1 (15).

¹⁰⁶ This is the calculation by IHS CERA (see: *Ibid.*, *Idem*).

¹⁰⁷ IHS CERA, *op. cit.*, pp. 1-5 - 1-6 (19-20).

¹⁰⁸ *Ibid.*, Figure 1-1, p. 1-8 (22).

¹⁰⁹ *Ibid.*, *Idem*.

US\$10bill per year from 2012 to 2035.¹¹⁰ The measure of the challenge appears clearly when considering that current investment levels are of only US\$1bill.¹¹¹

It must be noted that apart from oil and gas, Ukraine is also endowed with coal and has hydroelectric and nuclear production of electricity. However, the legacy of the Soviet Union in this respect has proved disadvantageous for the independent Ukraine. From one side, the preference of gas for thermal plants left them unsuited technically for the use of coal,¹¹² while nuclear power plants are obsolete and the potential was diminished after the accident of Chernobil.

Internal Energy Market

The transition from the Soviet Union to the independent Ukraine brought huge changes in the volumes of consumption, in a similar fashion to what had happened to the Russian Federation at the same time. That is, Ukraine suffered a collapse in demand in parallel with the rapid decay of its industry once it could not adapt to capitalism. One look at the figures shows clearly the dimension of the collapse: according to sources from the World Bank in 1996, productive consumption of electricity fell from 206.1bKWh in 1990 to 124.2bKWh,¹¹³ with industrial consumption, the main item, falling from 146.2bKWh to as little as 81.1bKWh.¹¹⁴ If adding consumer needs, which represented a small share compared to productive consumption, and which actually increased from 21.1bKWh to 27bKWh, total consumption of electricity in Ukraine fell from 1990 to 1996, from 227.3bKWh to 151.3bKWh.¹¹⁵ These changes were obvious given the fact that Ukraine's GDP fell a 68% from 1991 to 1997.¹¹⁶ This phenomenon obviously had an impact on the volumes of gas that were imported during those years: if Ukraine consumed in 1990 as much as 120bcm, a dramatic fall set in after the year 1992, until Ukraine was consuming a third less in 1997 with a reduced volume of 80bcm;¹¹⁷ consumption of gas was further reduced in the next years until it reached a nadir around 70bcm in the early 00s.¹¹⁸

One of the most conspicuous features of Ukraine's energy market has been the chaotic and changing nature of its internal market and the succession of different domestic actors along with the

¹¹⁰ *Ibid.*, p. 1-9 (23).

¹¹¹ *Ibid.*, p. 2 (8).

¹¹² Burakovsky, Igor V.: "The Ukrainian energy sector: current problems and perspectives", *Problems of Economic Transition*, vol. 40, no. 9 (January 1998), p. 39.

¹¹³ Burakovsky, *op. cit.*, p. 36, Table 1.

¹¹⁴ *Ibid.*, *Idem.*

¹¹⁵ *Ibid.*, *Idem.*

¹¹⁶ Pirani, Simon: "Ukraine's gas sector", Oxford Institute for Energy Studies (June 2007), p. 4, at <http://www.oxfordenergy.org/pdfs/NG21.pdf>.

¹¹⁷ IHS CERA, *op. cit.*, p. 2-2 (26), Figure 2-2.

¹¹⁸ *Ibid.*, p. 4, Figure ES-2, " Gas deliveries by category of user, 2000–10", p. 4.

catastrophic level of indebtedness during the 90s.¹¹⁹ These actors have been assuming and losing their preeminence alternatively depending on the volatile political circumstances of each moment. An enormous factor has been played here by one of the biggest scourges in the country, corruption. The fact is that until 1996 the system was somehow predictable thanks to the existence of one single actor, the state company "Ukrhazprom" which centralized gas imports.¹²⁰ This picture however, changed radically in 1996 when the government of Prime Minister Pavlo Lazarenko decided to end this centralized system and established a system of import quotas for private companies. State imports were reserved for the general population and state organizations.¹²¹ The system that was put in place, the gas trading concession system, was actually a recommendation from the IMF.¹²² The stated goal for this new system was to put an end to the harmful accumulation of debt to Russia which was disrupting energy relations within the complex triangle Russia-Europe-Ukraine.¹²³ However, this system failed miserably as it served Lazarenko to promote his sponsored company, United Energy Systems (UES), which was headed by Yulia Tymoshenko. Far from proving a useful device to liberalize the market as it was intended, it was turned into a tool of the new government to cartelize the market in its own profit. He started providing licenses to eight private companies, but this was soon reduced to only two, with UES being favored and being promoted in the rival stronghold of Donetsk (Lazarenko's base was Dnipropetrovsk), until UES managed to import as much as 50% of all natural gas for Ukraine.¹²⁴

Lazarenko had not respected Kuchma's policy of balance between all oligarchic clans (mainly, Kiev, Dnipropetrovsk and Donetsk),¹²⁵ with disastrous results. This led to the energy system within Ukraine to undergo a new and equally radical re-haul. The short-lived Prime Minister was sacked in 1997 as a result of his growing power and the threat it represented for President Leonid Kuchma. The decision was then taken to resurrect a state-centered system similar to that which prevailed under Ukrhazprom. Thus was created a new company "NAK Naftohaz Ukrainy" (henceforth Naftohaz) which would be run by a close associate of President Kuchma, Ihor Bakai'.¹²⁶ Bakai' himself, as could have been suspected, was not alien to the energy market, as he had been involved in the company "Respublika" (see next

¹¹⁹ Burakovsky, *op. cit.*, p. 41.

¹²⁰ Balmaceda, "Gas, oil and the linkages", *op. cit.*, p. 270.

¹²¹ *Ibid.*, *Idem.*

¹²² Pirani, "Ukraine's gas sector", *op. cit.*, pp. 7, 20.

¹²³ *Ibid.*, p. 20.

¹²⁴ Balmaceda, "Gas, oil and the linkages", *op. cit.*, p. 272.

¹²⁵ As Hans van Zon shows, Kuchma was a pragmatic balancer, at least before his second term, where he reinforced the Presidential Administration and leaned on the clan from Donetsk (see: van Zon, Han: "Political culture and neo-patrimonialism under Leonid Kuchma", *Problems of Post-Communism*, vol. 52, no. 5 (September/October 2005), pp. 13-14).

¹²⁶ "It's a gas: funny business games in the Turkmen-Ukraine gas trade", *Global Witness* (April 2006), p. 22, at http://www.globalwitness.org/sites/default/files/library/its_a_gas_april_2006_lowres.pdf.

chapter) and had then headed the company "Interhaz", which saw its quota reduced under the rule of Lazarenko. Ihor Bakai´ was thus a convenient ally to Kuchma.¹²⁷ The creation of Naftohaz may have secured for Kuchma control in a sector that would have otherwise enriched his future enemies, but it did not provide any guarantee for a healthy and transparent management of the energy sector in Ukraine. In fact, as the thorough report by *Global Witness* states: "*Bakai was the chairman of Naftohaz when all three of these practices were rife*"; "these practices", were illegal siphoning-off of Russian gas sent to Central and Western Europe, tax avoidance through barter schemes with producers and passing of the costs of gas to the Ukrainian state instead of consumers.¹²⁸ The Bakai´ system of management of the new state company proved to be no less of a disaster compared to the experiment undertaken by Lazarenko. The company accumulated a huge debt to Gazprom,¹²⁹ the Ukrainian state was sacrificed to private interests and Russia could not be assured of a flawless transit of its gas further West through Ukraine. Of course, it was widely suspected that Naftohaz served Kuchma´s interests directly as a source of patronage.

Naftohaz has been since its inception, and still remains so, the biggest actor in the Ukrainian market. It is however, not the only one and has started sharing some of its preeminence with new actors in recent times. Naftohaz is the producer of 90% of the whole domestic production, the owner of the pipeline system (through its filial "Ukrtransgaz") and controls the access to all consumers through its regional network of distribution (until November 2011 through another filial "Gaz Ukrainy").¹³⁰ However, Naftohaz has to share the turf with another set of subordinated actors which have nevertheless also taken on a life of their own and which represent an important opening for corruption as will be showed below; these actors are companies of regional and local distribution, "Oblgazy" and "Gorgazy" and although initially public owned, private actors have increased their presence in a sector which could become very lucrative if subsidizing of prices is lifted in the future.¹³¹ Besides them, those actors which have attracted the greatest attention during most of the period of independence of Ukraine are those called "Gazotreidery", or gas traders, which have played the role of intermediaries between Naftohaz and between producers in Russia and Turkmenistan; mainly four have held the upper hand since 1994 to

¹²⁷ *Ibid.*, p. 25.

¹²⁸ *Ibid.*, *Idem.*; the support provided to private companies through state debt is very well explained by Margarita Balmaceda (see: Balmaceda, "Energy dependency, politics and corruption", *op. cit.*).

¹²⁹ According to data provided by *Global Witness*, the debt to Gazprom in early 2000 amounted to US\$760mill (see: "It´s a Gas", *op. cit.*, p. 25).

¹³⁰ IHS CERA, *op. cit.*, p. 5-1 (53); there are exceptions to this picture, as some of the largest industrial groups own their own pipelines connected to Ukrtransgaz´s network (Pirani, "Ukraine´s gas sector", *op. cit.*, p. 58). Besides, some of the small producers that complement Ukraine´s gas production sell directly to consumers (*Ibid.*, *Idem.*).

¹³¹ Privatization became legal under the government of Viktor Yushchenko in 2000 (see: Duchêne, Gerard: "Équilibres institutionnels et performances économiques: le cas de l´ Ukraine", *Revue d´Études Comparatives Est-Ouest*, vol. 37 no. 4 (2006), p. 144.

2009: "Respublika", "Itera", "EuralTransGas (ETG)" and "RosUkrEnergo (RUE)". All of them were controversial and were suspected of concealing obscure interests by either corrupt private interests, Gazprom or the Ukrainian government itself (They are discussed in detail in the next chapter). Since the monopoly of Naftohaz was lifted in 2011, new actors of a similar kind have entered the Ukrainian gas market which besides being granted the right to import gas, have also acquired the right to sell directly to consumers. So far "Ostchem" of the DF Group (owned by Dmitro Firtash, former main owner of RosUkrEnergo) has been the main actor, but during the last year of Yanukovich's rule, other ones such as VETEK and DTEK had joined in, making Ukraine's energy market more diverse. Finally, there are some small traders that buy gas from independent producers (trading these, very small volumes as compared to Naftohaz) and sell it to industrial consumers.¹³² Some of these companies in 2006 were: "Metinvest Holding", "Industrial Union of Donbass", "Shell Energy Ukraine Ltd", "Energoalians", "Energoinvest", "Gazservis Trading House" and "Poltavskii GZK".¹³³

The biggest characteristic in Ukraine's gas market, similar in that to the Russian Federation, is that prices which are regulated by the National Electricity Regulatory Commission (NERC) are differentiated. There exist in fact three categories: industrial users that have non-regulated prices, residential users with regulated prices and district heating utilities that enjoy semi-regulated prices. The difference lies in the share of imported (market-based) or domestic and low priced natural gas, while semi-regulated prices for heating correspond to a mix of both sources.¹³⁴ Many of the liabilities that Naftohaz has been suffering stem from this system, as semi-regulated prices have been kept below what the market share should have determined since prices started growing from 2006.¹³⁵ This has forced the state to sustain the company's financial losses, especially as the share of imported gas ended up making up most of the gas needed for this sector.¹³⁶ The fact that many district heating companies are indebted to Naftohaz makes the financial

¹³² As can be shown in Pirani, "Ukraine's gas sector", *op. cit.*, Figure 1. "The Ukrainian domestic gas market", p. 55.

¹³³ *Ibid.*, Table 5.6. "Major holders of supply licences", 2006, p. 63; to these Simon Pirani also mentions those registered in statistics as of March 2006: Gaztreid and Slavia (*Ibid.*, p. 62, ft. 95).

¹³⁴ IHS CERA, *op. cit.*, p. 5-3 (55).

¹³⁵ According to a decree from 2002, Naftohaz would sell its domestic production to residential consumers and state-controlled organizations while Russian gas received in the form of transit tariff, and priced at only US\$50tcm at the time was reserved for district heating companies (see: Pirani, *op. cit.*, p. 55.). Thus changes since 2006 necessarily affected this sector which could not rely much on "domestic gas" priced more cheaply. Since then, only households and publicly funded institutions receive Ukrainian gas, while the rest of consumers rely on imported volumes. Prices for the heating sector have been increasing, almost in parallel with those for households and public institutions, and moving further up (see: IEA, "Ukraine", *op. cit.*, Figure 7.9, "Import and end-user natural gas prices, 2004-12", p. 125) but still far below import prices, as can be seen when compared to prices in the industrial sector (see: *Ibid.*, *Idem.*).

¹³⁶ IHS CERA, *op. cit.*, p. 5-4 (56): financial woes of the company have been compounded by other factors too: its filial Ukrnafta, which also produces a small share of gas (2bcm) has been refusing to sell part of it (around half of its whole production) to Naftohaz at regulated prices while Ostchem's share in the industrial sector (where prices are sold at market prices and where gains can be made) has pushed out Naftohaz from a big part of that lucrative market.

situation of the state company even more delicate.¹³⁷ However, not only prices for heating and the industrial sector had to increase due to changes in pricing for imported gas from 2006.¹³⁸ Prices for the industrial sector did follow import prices, but as for prices in the heating sector, as the International Energy Agency wrote in its report on Ukraine in 2012, they were still below cost recovery and did not thus allow funds for modernization.¹³⁹ Prices for residential customers (those most subsidized), increased too from 2006. As Simon Pirani explains, after certain price increases in the regulated sector in the mid-90s, prices did not move from April 1999 to April 2006. Then in May 2006 changes started with new increases by 25%, soon followed by an even sharper one of 80% on the 1st July 2006 and then complemented by a smaller 2–15% from the 1st January 2007,¹⁴⁰ while the government of Viktor Yanukovich tried to soothe the impact on lower-income households by delaying the introduction for less affluent sectors of the population.¹⁴¹ As a result, in the category of residential customers, ceilings for wholesale prices moved from uah185tcm in 2006 to uah423 one year later.¹⁴² Prices would increase again in 2008 by a combined 50%. In 2009 increases as an obligation from the IMF in the framework of the loan agreements subscribed then, were delayed until August 2010, when they increased again by 50%.¹⁴³

¹³⁷ *Ibid.*, pp. 5-4 (56) - 5-5 (57); this problem persists at the time of writing in early 2014, as Naftohaz insisted in early February to be unable to pay its debts to Gazprom (which amounted to US\$3,3bill according to the Russian monopoly; see: "Gazprom" podschital, skol'ko emu dolzhen "Naftogaz": poluchilos' \$3,3mlrd ("Газпром" подсчитал, сколько ему должен "Нафтогаз": получилось \$ 3,3 млрд)", *Zerkalo Nedeli*, 3 February 2014, at

http://zn.ua/ECONOMICS/gazprom-podschital-skolko-emu-dolzhen-naftogaz-poluchilos-3-1-mlrd-138026_.html (Accessed on the 6th February 2014) due to accumulated debts from district heating companies (see: "Naftogaz" v ocherednoi' raz zaiavil, chto ne smozhet zaplatit' "Gazpromu" iz-za 27 mlrd dolgov teplokomunenergo ("Нафтогаз" в очередной раз заявил, что не сможет заплатить "Газпрому" из-за 27 млрд долгов теплокомунэнерго)", *Zerkalo Nedeli*, 3 February 2014, at http://zn.ua/ECONOMICS/naftogaz-v-ocherednoy-raz-zayavil-chto-ne-smozhet-zaplatit-gazpromu-iz-za-27-mlrd-dolgov-teplokomunenergo-138011_.html (Accessed on the 6th February 2014).

¹³⁸ Prices for district heating companies increased in 2005 (Malygina, Katerina: "Populist games: discourse on domestic gas prices in Ukraine in 2005-2011", 4th ECPR Graduate Conference (4th-6th July 2012), p. 11, at ecpr.eu/Filestore/PaperProposal/1370c79b-13ac-4974-9a41-ad8616eaa525.pdf, but the capacity for the NERC to raise prices was limited by the fact that the competence for this lays in Oblast and municipal authorities too, which have an interest in keeping prices as low as possible for political convenience (see: IEA, "Ukraine", *op. cit.*, p. 57). A new regulating body called the National Commission for Regulation of Municipal Services has reduced the autonomy municipalities had in setting tariffs (*Ibid.*, pp. 57-58); however at the time of drafting its report in 2012, the IEA considered that potential changes had not yet materialized, with many district heating companies not regulated by the municipal regulator, still keeping their tariffs subsidized by the municipalities (*Ibid.*, p. 59).

¹³⁹ IEA, "Ukraine", *op. cit.*, p. 58; this is compounded by the fact that the payment rate from residential consumers for heating bills ranges from 75% to 85%, thus creating a debt problem for the district heating companies (*Ibid.*, *Idem.*); in addition, municipalities, which tend to set tariffs as low as possible, not always provide the needed subsidies to the heating companies, creating an additional source of indebtedness (*Ibid.*, p. 59). The coverage of average tariffs was calculated by the IEA as 70%, covering generation but not modernization investments (*Ibid.*, p. 59).

¹⁴⁰ Pirani, "Ukraine's gas sector", *op. cit.*, p. 60.

¹⁴¹ *Ibid.*, p. 61; this was agreed upon in January 2007 after the transitory measure taken by the government in October 2006, to reduce by 20% the tariff for households after the sharp combined increases of May and July (see: Malygina, *op. cit.*, p. 13).

¹⁴² Pirani, "Ukraine's gas sector", *op. cit.*, p. 60, Table 5.5; in fact, as Katerina Malygina explains (Malygina, *op. cit.*, p. 11), changes first started in late 2005 as a result of the rise in prices of Turkmen gas that had taken place that year; thus, prices were raised for district heating companies.

¹⁴³ Malygina, *op. cit.*, p. 14; this loan, amounting to US\$16.4bill (US\$11bill were released to which US\$3.4bill under a Stand-by Agreement from mid-2010 were added) was agreed to in November 2008 and was meant to stabilize the banking system. In

Since then, no more price increases took place,¹⁴⁴ until 2014-15, after the fall of Yanukovich and under the Administration of Petro Poroshenko. However, since the last price hike (August 2010), households devoid of meters pay more than those which have installed them.¹⁴⁵ IMF pressure on raising gas prices is one of the explanations why cooperation was severed by Ukraine and new advantageous price arrangements were agreed with Russia in December 2013. A similar pattern can be found as for tariffs in the electricity generation sector, which had increased in 2006, 2007, in 2011,¹⁴⁶ and again in 2014 and 2015.

But why had prices to move up for residential customers too, while they consume domestic gas? There seemed to be political reasons for that, as President Yushchenko wanted to bring prices on line with those much higher in the rest of Europe.¹⁴⁷ However, it also seems that economic imperatives forced the situation. One plausible explanation is that actually, prices for residential customers did not even cover costs of production; while Naftohaz did have the right until 2006 to sell gas (bought from the intermediary RosUkrEnergo) and thus earn profits which could subsidize prices linked to domestic gas,¹⁴⁸ this was forbidden by the agreements of January 2006 and confirmed in those of January 2009. The public sector, which falls into the same category of regulated prices, has seen gas prices since 2005 remain flat once the inflation is taken into account.¹⁴⁹

Energy Efficiency

Along with the under-exploitation of its internal resources, Ukraine faces another problem that has been only partially solved to date and whose significant potential remains thus largely untapped, which is energy efficiency. Simon Pirani calculated back in June 2007 an energy coefficient of 2.61 for Ukraine, representing the ratio of consumption per GNP, more than Russia with 2.47 and far from countries like the UK and Germany, with much lower coefficients of 0.67 and 0.76 respectively.¹⁵⁰ Interestingly, Poland, former member of the CMEA, had achieved by then a coefficient of 1.00.¹⁵¹ Following the coefficients calculated by the International Energy Agency (IEA), in 2010 Ukraine had a coefficient of 1.44 and the

exchange, Ukraine had to approve a set of reforms focused on the budget deficit, the exchange rate and energy policy (IEA, "Ukraine", *op. cit.*, p. 20).

¹⁴⁴ IEA, "Ukraine", *op. cit.*, p. 124.

¹⁴⁵ *Ibid.*, p. 125: consumers without meters pay US\$150tcm, whereas those with installed meters, pay 33% less, US\$100tcm.

¹⁴⁶ IEA, "Ukraine", *op. cit.*, p. 171, at

http://www.iea.org/publications/freepublications/publication/Ukraine2012_free.pdf (Accessed on the 14th April 2014).

¹⁴⁷ Pirani, "Ukraine's gas sector", *op. cit.*, pp. 60-61.

¹⁴⁸ Malygina, *op. cit.*, p. 10.

¹⁴⁹ IEA, "Ukraine", *op. cit.*, p. 124.

¹⁵⁰ Pirani, Simon: "Ukraine's gas sector", *op. cit.*, p. 11.

¹⁵¹ *Ibid.*, *Idem.*

Russian Federation one of 0.78.¹⁵² While Ukraine's energy intensiveness grew by 30% from 1991 to 1995, it stabilized during the rest of the decade and then Ukraine managed to reduce it by a considerable 40% from 2000 to 2005,¹⁵³ the fact that Ukraine still held such position at the time means it clearly lagged behind in international standards.

However, significant improvements were done since 2006 as a consequence of the annual increase in gas prices that started that year as a consequence of the January 2006 gas dispute and which culminated with the imposition of market prices for Russian gas after the January 2009 gas dispute.¹⁵⁴ The main weak point in the Ukrainian economy is the importance of high consumption in the heavy industry, with industrial consumers using as much gas as residential consumers do.¹⁵⁵ As Figure 4-3 from IHS CERA report shows, there was a certain reduction in consumption from 2005 to 2008, which corresponds with those years when Ukraine started facing higher prices and had thus an important incentive to increase efficiency.¹⁵⁶ The sudden drop in consumption cannot however be related (or at least only partially) to the same phenomenon, as it also coincided with the onset of the financial crisis that severely hit y Ukraine's industrial sector. The level of consumption has remained lower since 2009,¹⁵⁷ not only because of economic circumstances though, as improvements in efficiency have continued.

The situation in the industrial sector is the following: The chemical industry consumes 8bcm to 8.5bcm annually. It has a great degree of energy intensiveness due to its being mostly geared to the production of nitrogenous fertilizers, where roughly 75% of the production costs depend on energy.¹⁵⁸ The two complexes of "CherkasskAzot" and "RivneAzot" reported substantial reductions from 1990 to 2010 in energy intensiveness, while prospects of further improvement seemed positive in the light of recent

¹⁵² IEA (2012): "Energy Balance of Non-OECD Countries", p. II. 433 (515), at <http://www.iea.org/media/training/presentations/statisticsmarch/BalancesofNonOECDCountries.pdf> (Accessed on the 6th February 2014); the energy intensity to GDP was 10 times than the OECD average and 3.2 times more in purchasing parity power terms, even through taking into account shadow economy of around 34% would lower these figures (IEA (2012): "Ukraine", *op. cit.*, p. 20).

¹⁵³ Pirani, "Ukraine's gas sector", *op. cit.*, p. 12.

¹⁵⁴ IHS CERA, *op. cit.*, p. 4-1 (39).

¹⁵⁵ *Ibid.*, *Idem.*

¹⁵⁶ *Ibid.*, Figure 4-3, p. 4-2 (40)

¹⁵⁷ This can be seen for example in: IHS CERA, *op. cit.*, Figure 5-7, p. 5-6 (58); the figure shows global consumption: if in 2008 Ukraine imported 66.6bcm of gas, in 2010 it was importing only 57.7bcm. Consumption in 2011 surged slightly to 53.9bcm and fell the next year to 54.7bcm (see: "Україна скоратила потреблення газу на 7,6% (Украина сократила потребление газа на 7,6%)", *Kommersant*, 24 January 2013, at <http://www.kommersant.ua/news/2112042> (Accessed on the 4th February 2014)).

¹⁵⁸ IHS CERA, *op. cit.*, p. 4-3 (41). According to the IEA, roughly 80% (IEA, "Ukraine", *op. cit.*, p. 103) efficiency improvements in this sector are bound to have an important impact on the whole energy intensity of the Ukrainian economy, as this accounts for 7% of the country's GDP and 8% to 10% of all export earnings (IHS CERA, *op. cit.*, p. 4-3 (41)).

announcements.¹⁵⁹ The assessment by the IEA in 2012 was not very optimistic in the light of the industry's approaching pre-crisis consumption levels.¹⁶⁰ The metals' sector consumes about 8.5bcm to 9.5bcm annually. This is why it is one of the main sectors regarding gas consumption in Ukraine and the reason for its high inefficiency, compared to international standards.¹⁶¹ This means there is a great potential for improvement. A process of modernization is in fact taking place in this sector which should therefore fulfill many of the promises inherent in the application of more modern technology. According again to IHS CERA, there could be a potential for 44% (3.9bcm) savings taking 2007 production levels as a benchmark.¹⁶² The global consumption in industry went from 35bcm to 30bcm four years later, and then down to 18.4 bcm in 2009 due to the crisis, to bounce back to 24.6 bcm in 2011.¹⁶³

Important changes have also taken place in other sectors: The most spectacular success has taken place in the power sector, which from 2000 to 2010 has managed to reduce consumption by a staggering 75%, that is, from 12bcm to 3bcm annually.¹⁶⁴ This is explained by the fact that most thermal power stations were built in the 60s to 70s as coal-fired plants but endowed with flexibility to switch to gas. For this reason, after having been mostly turned to gas, returning to coal was not difficult.¹⁶⁵ This sector also enjoyed a relatively good starting position due to the significant share of nuclear energy in power generation.¹⁶⁶ Another sector which deserves attention is that of district heating and households, which has inherited many shortcomings from the Soviet legacy, mainly the fact that gas meter installations were

¹⁵⁹ *Ibid.*, *Idem*; the exact data of the increase in efficiency are the following: CherkasskAzot reduced the ratio of gas per ton of ammonia in the period 1990-2010 from 1.46bcm to 1.12bcm; such reduction, interestingly, seems to have taken place in the last four years, in coincidence with the increase of gas prices from January 2006. RivneAzot is reported to have reduced the ratio from 1.24bcm to 0.99bcm in 2007 owing to the reconstruction of some of its units. At the time of publication of the IHS CERA report, the DF Group (main producer in the sector) was working on further modernization leading to a 20% reduction in gas consumption from the output registered in 2007. If applied to the whole, modernization would yield a reduction in 1.7bcm per year (*Ibid.*, p. 4-4 (42)).

¹⁶⁰ IEA, "Ukraine", *op. cit.*, p. 102.

¹⁶¹ IHS CERA, *op. cit.*, p. 4-5 (43): these costs (50%) represent roughly twice as much as the global average (20% to 25%).

¹⁶² *Ibid.*, *Idem*; if one is to believe reports as published by *Ekonomichna Pravda* in December 2013, the share of natural gas in global costs of metal production would have fallen to only 5-7% (see: Vyshinskii', Andrei': "Ianukovich "leg" pod mosckvu. Chto vzamen? (Янукович "лег" под Москву. Что взамен?)", *Ekonomichna Pravda*, 17 December 2013, at <http://www.epravda.com.ua/rus/publications/2013/12/17/409320/> (Accessed on the 5th February 2014)).

¹⁶³ IEA, "Ukraine", *op. cit.*, p. 102.

¹⁶⁴ A single reduction by half took place from 2005 to 2006 (IHS CERA, *op. cit.*, p. 4-6 (44)). Savings in the thermal power sector started as soon as 2001, when consumption was cut by 33% next year (from 12bcm to 8bcm) (*Ibid.*, Figure 4-7, p. 4-7 (45)). Coinciding again with unexpected increases in gas prices in 2006, a reduction of as much as 6.5bcm in the period 2006-2007 (see: *Ibid.*, Figure ES-2, p. 4 (10)), may not be ascribed either to the power sector (in fact, in 2007, consumption there jumps back to 2005 levels), or to economic slowdown (2006 and 2007 witnessed an increase in GDP growth of 7.3% and 7.9% respectively compared to only 2.7% in 2005. See: Global Finance: <http://www.gfmag.com/gdp-data-country-reports/154-ukraine-gdp-country-report.html#axzz2sR8vxa00>). Therefore, significant savings must have been made in other sectors.

¹⁶⁵ IHS CERA, *op. cit.*, p. 4-6 (44); closely related to the power sector, the electricity transmission and distribution sector has a certain potential for improvement in terms of efficiency, as losses were calculated by the IEA in 2012 to represent as much as 13% (IEA, "Ukraine", *op. cit.*, p. 46).

¹⁶⁶ As of 2014, nuclear share in power generation amounted to as much as 49.39% (see: <http://www.iaea.org/PRIS/CountryStatistics/CountryDetails.aspx?current=UA> (Accessed on the 22th April 2015)).

inexistent. A certain jump in efficiency in households' consumption seems to have happened from 2006 to 2007, where the volume of gas was reduced by around 1bcm.¹⁶⁷ While reduction in district heating has proceeded constantly since 2003 with a big reduction in 2007 again, it seems that as of 2011-12, reductions have not been substantial.¹⁶⁸ Other sectors where there is potential for saving and where progress has also been made, are: the category where the rest of the industry is lumped together, which consumed in 2006 as much as 11bcm and which managed to reduce consumption in 2008 to 1bcm less.¹⁶⁹ Ukraine also consumes a sizable amount of technical gas to power gas pipelines needed not only for its own gas, but also for Russian gas that has to transit the country. With total technical needs amounting to almost 7bcm in 2007,¹⁷⁰ the reduced transit of Russian gas is surely proving an important factor in the last years.¹⁷¹ However, the bulk of the savings made to date might be related to technical improvements instead. According to Naftohaz in 2007, there were potential savings of 3.9bcm a year.¹⁷² As reported by the IEA, substantial reductions have already happened, with technical gas falling from 6.6 bcm in 2005 to just half thereof, 3.3 bcm in 2010.¹⁷³ The major technical improvement made here is related to the substitution of gas pumping stations by electrical units; according to Ukrtransgaz, about 35% of the pumping units were electric by end 2011, something that allowed the company to save 0.41 bcm of gas in 2011 alone.¹⁷⁴ Still, one caveat here is necessary, as before Nord Stream, Russian gas transit was already reduced substantially.¹⁷⁵

¹⁶⁷ IHS CERA, *op. cit.*, Figure 4-10, p. 4-11 (49).

¹⁶⁸ *Ibid.*, Figure 4-11, p. 4-12 (50); here a non-negligible factor may be temperature fluctuations from year to year which could account for changes exogenous to gains made in efficiency. However, a certain trend seems to register from 2003, which can be attributed to modernization and switching to coal in the big Kyivenergo combined heat and power (CHP) plant (IEA, "Ukraine", *op. cit.*, p. 101-102). As can be seen in the report by IHS CERA (*op. cit.*, Figure 4-11, p. 4-12 (50)), the biggest reduction comes from consumption in the city of Kyiv. Still, according to the IEA in its report from 2012, there was a rate of as much as 15% in heat losses (in some cases much more) located in the production stage (IEA, "Ukraine", *op. cit.*, pp. 46, 55) while the rate of heat losses in the distribution network amounts to at least 17% (*Ibid.*, p. 55). The potential for reduction if all possible modernization and efficiency measures were introduced, according to the Ministry of Regional Development, Construction and Building, would amount to about 3bcm (*Ibid.*, *Idem*); however, the same ministry approved a plan to reduce consumption between 5bcm-6bcm in 2020 (*Ibid.*, p. 60). In 2011 the sector consumed around 13bcm (*Ibid.*, p. 60), compared to the peak above 14bcm in 2003 (IHS CERA, *op. cit.*, p. 4-12 (50)).

¹⁶⁹ IHS CERA, *op. cit.*, Figure 4-9, p. 4-10 (48); consumption fell drastically to slightly above 6bcm in 2009, probably as a result of the financial crisis, where Ukraine registered a fall of 14,8% of its GDP.

¹⁷⁰ *Ibid.*, Figure 4-12, p. 4-12 (50).

¹⁷¹ In 2013 Russia reduced transit of gas through Ukraine to 52% (see: "Cherez territoriiu Ukrainy v 2013 godu "Gazprom" transportiroval 52% prodannogo v Evropu gaza (Через территорию Украины в 2013 году "Газпром" транспортировал 52% проданного в Европу газа)" *Zerkalo Nedeli*, 30 January 2013, at http://zn.ua/ECONOMICS/cherez-territoriyu-ukrainy-v-2013-godu-gazprom-transportiroval-52-prodannogo-v-evropu-gaza-137794_.html (Accessed on the 6th February 2014), as compared to near 100% rates in the 90s or 80% during the period 2005 to 2009.

¹⁷² IHS CERA, *op. cit.*, p. 4-11 (49).

¹⁷³ IEA, "Ukraine", *op. cit.*, p. 104.

¹⁷⁴ *Ibid.*, *Idem*.

¹⁷⁵ Nord Stream did not start working until 2011 and explains the big reduction in gas transit since then. 2009 and 2010 witnessed a big but temporary reduction due to the economic crisis (see: IHS CERA, *op. cit.*, Figure 2-3, p. 2-3 (27)). A downward tendency is registered since 2004, with the total gas transit being reduced from 140bcm to under 100bcm since 2009

(see: *Ibid.*, *Idem.*), which seems to be explained mostly by the full functioning of Blue Stream from 2006 (IEA, "Ukraine", *op. cit.*, pp. 112-113). Transit of Russian gas through Ukraine in 2013 amounted to 83.7bcm ("cherez territoriui", *op. cit.*).

Chapter 4: Russia-Ukraine Energy Relations

4. 1. General Picture of Russo-Ukrainian Relations in the First Years of Independence

Both The Russian Federation and Ukraine have inherited from the Soviet Union a troublesome pattern of energy relations which has marred their relations ever since then. The problem was that in a similar fashion as happened in trade between the Soviet Union and the CMEA countries, and as it will be briefly mentioned in the next chapter, energy trade was subsidized.¹ As Simon Pirani points to, it was neither politically desirable nor practically possible to deny Ukraine shipments of needed fuel while the country had troubles making payments.² Thus, Russia was entangled in a pattern of subsidization that would bring her continuing headaches for the years to come. Gregory Krasov and Josef Brada analyzed this pattern of subsidization for the period 1992-1997 in what regards oil and gas trade prices, tariffs and energy credits. They thus highlighted the main elements that have characterized mutual energy relations since then. Both countries have been living in almost unsolvable tension since the break-up of the Soviet Union, for as soon as Ukraine became independent, the dilemma of maintaining energy subsidization instead of enforcing a transition towards market prices increased for Russia with the heightened opportunity costs.³ As the authors rightly point to, initial interest among analysts regarding a possible liberalization of trade between the former Soviet republics, obscured the issue of conflict that was soon to develop between many of them. In this respect, the Russia-Ukraine dyad was probably the most troublesome. Margarita Balmaceda rightly pointed out that the dissolution of the Soviet Union and its centralized rule was far from meaning the disappearance of a Russia-centric economic network and its ensuing dependency. This was manifestly the case in Ukraine.⁴ Both the disputes analyzed later and the most recent events as of 2014 show that the dilemma is far from being solved.

With a huge level of dependence of Ukraine on Russia for its oil and gas imports (as was seen in the previous chapter, Ukraine's gas resources suffered severe depletion during the decade of the 80s), the Ukrainian Soviet Socialist Republic had been enjoying imports of underpriced energy resources. After a central bank clearing system had failed to come to light, the Russian Federation announced in 1992 that

¹ Krasnov, Gregory V. and Brada, Josef C.: "Implicit subsidies in Russian-Ukrainian energy trade", *Europe-Asia Studies*, vol. 49, no. 5 (Jul., 1997), p. 825.

² Pirani, Simon: "Ukraine's gas sector", Oxford Institute for Energy Studies (June 2007), pp. 4-5, at <http://www.oxfordenergy.org/pdfs/NG21.pdf>.

³ Here, following Krasnov and Brada, the concept of subsidization follows Marrese and Vanous' theorization of implicit subsidies, which is yielded by using world prices in free markets as the benchmark (Krasnov and Brada, *op. cit.*, p. 825).

⁴ Balmaceda, Margarita M.: "Gas, oil and the linkages between domestic and foreign policies: the case of Ukraine", *Europe-Asia Studies*, vol. 50, no. 2 (1998), p. 257.

trade would henceforth be conducted at world market prices. This represented a radical departure from the pattern that existed under the Soviet Union.⁵ The transition to market prices affected oil, already in 1993. However, the story with natural gas was a much more complex one. Although Ukraine depended on Russia for its gas supplies, this should not lead to the conclusion that the former's bargaining power was nil. In parallel with that dependency, as was already mentioned in the first chapter, Ukraine held a privileged position as transit country. It could therefore demand a transit tariff for Russian gas and more importantly, affect supplies through its territory. The result of this situation of mutual dependency was the agreement of early 1994, where the gas price for Ukraine was set at US\$50tcm in exchange for a low transit fee for Russian gas that had to traverse Ukraine to reach consumers further West of 0.65tcm/100km.⁶ This agreement was revised the next year so the transit fee moved up to 1.75tcm/100km.⁷ However, credits offered by Russia to Ukraine entered the picture. These credits had been provided in order to finance energy purchases both in oil and gas. They transformed into an element that still mars common relations as of today: debt. In May 1993 it was agreed that Ukraine owed a debt of US\$1.5bill plus US\$1bill of arrears for energy deliveries in the period 1991-1992 and US\$203.9mill as agreed one month later for energy deliveries for the current year.⁸ The Ukrainian debt further worsened with an addition of US\$1.4bill in 1994.⁹ No solution could be eventually found and debt accumulation and disputes persisted in the coming years until a new arrangement was found in 1998 to reschedule debt.¹⁰ As for prices, the situation improved for Russia. Already in 1995, when Ukraine was offered a higher transit fee, prices were agreed at US\$80tcm, raising them to world market levels.¹¹ Besides that, producer diversification took place in Ukraine, as compared to 51bcm of gas that was imported from Russia in 1995, Russian natural gas supply dropped next year to a meager 12bcm.¹² This was the result of Turkmen gas coming to fill the gap. Finally, in December 1996 a new agreement was reached between Ukraine and Gazprom which set the transit fee at the level of US\$1.77tcm/100km and where it was agreed that this fee would be paid in gas for Ukraine's consumption.¹³ It must be noted, that Ukraine

⁵ Krasnov and Brada, *op. cit.*, p. 827.

⁶ *Ibid.*, *Idem.*

⁷ *Ibid.*, *Idem.*

⁸ *Ibid.*, pp. 827-828.

⁹ *Ibid.*, p. 828.

¹⁰ *Ibid.*, *Idem.*

¹¹ *Ibid.*, *Idem.*

¹² *Ibid.*, *Idem*; figures in the same article (*Ibid.*, table 1, p. 830) show in contrast to the figure of 51bcm mentioned, 66.3bcm of Russian gas for 1995, which might be explained by supplies out of contract.

¹³ Balmaceda, "Gas, oil and the linkages", *op. cit.*, p. 269.

unsuccessfully tried to agree with its Russian counterpart that part of the fees were paid in money instead of gas deliveries.¹⁴

According to calculations made by Krasov & Brada, the most likely figure for subsidies in the period 1992-95 was US\$9.5bill.¹⁵ If we compare these subsidies as a percentage of the imports of Ukraine from the FSU space, they amounted to 30.5%. If in energy relations between the former USSR and CMEA countries this was only 17.6%, then we can follow the authors in their assertion that independent Ukraine was favored as compared to Central European countries in the former CMEA space. The authors list three probable reasons for this: Russian dependence on Ukraine as a transit country; Russia's interest in Ukraine's economic stability and pressure from the international community to ensure this stability.¹⁶ Whatever the reason, the fact is that the pattern that may have reached an extreme during the first years of independence, nevertheless endured in the coming years. Disputes involving gas cut-offs, in a lower dimension than in January 2006 and January 2009, but often affecting end-consumers, happened several times during these years.

4. 2. Gas Disputes and Energy Agreements

Recurring gas disputes happened in the 90s as a result of all the debt accumulated by the Ukrainian side in the midst of an economic collapse which was affecting the whole former Soviet Union. Debt issues for Gazprom during these years were substantial. In the case of Ukraine, we may see that the percentage of gas bills paid from 1995 to 1998 was 80.1%, 90.36%, 88.85% and 70.26%.¹⁷ For three years, 1992, 1993 and 1994, Russia cut off gas deliveries to Ukraine as a result of Ukraine's indebtedness.¹⁸ In a pattern which would re-emerge in full swing in the convulsed period from 2005 to 2009, Ukraine responded, siphoning gas off from transit gas, something which Ukraine's near monopoly of Russian supplies to Europe enabled. Two instances of gas diversion were acknowledged by Ukraine, in September 1993 and

¹⁴ *Ibid.*, *Idem.*

¹⁵ Krasnov and Brada, *op. cit.*, p. 836.

¹⁶ *Ibid.*, pp. 839-840.

¹⁷ Stern, Jonathan: "Soviet and Russian gas: the origins and evolution of Gazprom's export strategy", in Mabro, Robert and Wybrew-Bond, Ian (1999): *Gas to Europe: the strategy of four major suppliers*, Oxford Institute for Energy Studies, Oxford University Press, p. 156, Table 5. As can be seen in table 5, Ukraine was not in fact the worst debtor of Gazprom, at a time when even from the Baltic countries debt accumulated; during that period, Belarus and specially Moldova, had a worse level of indebtedness to Gazprom than Ukraine. What set Ukraine apart though, was the size of its economy, which made this indebtedness more critical for the Russian monopoly. As Jonathan Stern explains, despite the critical importance of revenues from Ukraine, Russian dependence on its neighbor to ensure transit further West explains Russia's relatively conciliatory stance (see: *Ibid.*, p. 158). Another element that sets Ukraine apart from the Baltic states, Belarus and Moldova, is its adamant refusal to let Gazprom gain any ownership of its energy infrastructure (see: *Ibid.*, p. 159).

¹⁸ Pirani, "Ukraine's gas sector", *op. cit.*, p. 19.

November 1994, but Russia claimed on many occasions that Ukraine was still siphoning gas off at the expense of customers in Europe.¹⁹

The period of independence in Ukraine was greeted with great uncertainties as for the energy future of the country, as Ukraine was extremely dependent on gas and oil imports that could only come from CIS countries, mainly Russia and Turkmenistan. Prime Minister Vitold Fokin claimed in March 1992 to have secured agreements with Russian companies to guarantee enough supplies.²⁰ However, clouds were gathering in Turkmenistan. Turkmen gas was also necessary for Ukraine in addition to Russian gas and thus, negotiations with Ashgabad were needed too, in order to agree on deliveries. Turkmen conditions were extremely advantageous for the first quarter, with a price of US\$8tcm. However, prices would shoot up to US\$73tcm in the second quarter.²¹ Fokin negotiated and from an initial offer of only US\$20, Ukraine managed to agree on a price even lower than for the first quarter. However, the Ukrainian side insisted on having transport costs included.²² Deadlock ensued and Ukraine responded by suspending good deliveries to Turkmenistan. Even if that was not eventually carried out, Ukraine went as far as to threaten Ashgabad with closure of the export route to Western Europe.²³ The result of this situation was that Ukraine had to rely exclusively on Russia²⁴ until an agreement was reached in September 1992 for deliveries in the fourth quarter (US\$12tcm), while prices for 1993 were to be negotiated later.²⁵ However, problems soon came from Russia too and Ukraine was heading for its first gas dispute.

This dispute happened in October 1992 when Ukraine siphoned off gas and provoked a situation in which for around 10 days Germany saw its supplies reduced in 20%-50%.²⁶ Although price and transit conditions had been agreed in the month of August, Russia had to resort to a reduction of supplies in October as it accused Ukraine of not adhering to the conditions agreed. The only alternative for Ukraine was to siphon gas off at the expense of Germany's energy security.²⁷ This was the context in which Russia announced an increase of gas prices to "world market prices" for next year, to start from January 1st. This put Ukraine in a critical situation and eventually led then Prime Minister Leonid Kuchma to declare an

¹⁹ *Ibid.*, *Idem*.

²⁰ Smolansky, Oles M.: "Ukraine's quest for independence: The fuel factor", *Europe-Asia Studies*. vol. 47 no. 1 (Jan 1995), p. 68.

²¹ *Ibid.*, *Idem*.

²² *Ibid.*, pp. 68-69.

²³ *Ibid.*, p. 69.

²⁴ Stern, Jonathan P. (1995): *The Russian Natural Gas "Bubble": Consequences for European Gas Markets*, The London, Royal Institute for International Affairs; Washington D.C., The Brookings Institution.

²⁵ Smolansky, "Ukraine's quest for independence", *op. cit.*, p. 73.

²⁶ Stern, "The Russian Natural Gas "Bubble"", *op. cit.*, p. 60.

²⁷ Smolansky, "Ukraine's quest for independence", *op. cit.*, p. 72.

"energy crisis" in May.²⁸ An agreement had been reached in February 1993, where gas would be sold at US\$37tcm and the transit tariff set at US\$0.43tcm/100km, but Prime Minister Kuchma complained that Russia had breached its commitments on petrol deliveries and thereafter the situation degenerated to the point that the Russian side decided to be true to its previous announcement in 1992 and sell gas at world prices of US\$85tcm. Ukraine then retaliated with a transit tariff of US\$3.00tcm/100km.²⁹ It is thus not surprising that new reports of gas diversions, which Ukraine denied, were reported in March 1993 (until that month, insufficient oil deliveries to Ukraine from Russia were also reported)³⁰ and that in September supply problems were reported in Turkey, Bulgaria and Rumania (this time, as already mentioned in the paragraph above, this was acknowledged by Ukraine).³¹ In June both countries agreed on a price for gas of US\$80tcm. This price was quite high if compared to those paid by other countries in Central Europe.³²

Western Europe would soon experience new problems when Russia again decided in February 1994 to partially suspend gas deliveries to Ukraine.³³ This led Ukraine again to use transit gas, siphoning off as much as 20% of normal supplies to Europe and provoking a fall in deliveries in Germany, France and Italy.³⁴ This month *horribilis* was compounded by the fact that not only supplies from Russia, but also supplies from Turkmenistan were suspended due to non-payment from the Ukrainian side and debt accumulation (US\$671.9mill).³⁵ This cut-off put Ukraine in a critical situation which was solved when Turkmenistan accepted its debt to be sold to the intermediary company Respublika (see below).³⁶ As for the dispute with Russia, it ended with the signing of the first inter-governmental agreement, signed that same month and which appeared to be a promise of stable relations between both provider and consumer. Unfortunately this new agreement did not bring order.³⁷ One possible reason for this was that the

²⁸ Fujimori, Shinkichi: "Ukrainian gas traders, domestic clans and Russian factors: a test case for meso-mega area dynamics", in Matsuzato, Kimitaka (2005): *Emerging meso-mega areas in the former socialist countries*, Slavic Eurasian Studies, no. 7, Sapporo, Hokkaido Slavic Research Center, Sapporo University, p. 120, at http://src-h.slav.hokudai.ac.jp/coe21/publish/no7_ses/chapter06.pdf.

²⁹ Smolansky, "Ukraine's quest for independence", *op. cit.*, p. 73.

³⁰ *Ibid.*, p. 77.

³¹ Stern, "The Russian natural gas "bubble", *op. cit.*, p. 60.

³² Balmaceda, "Gas, oil and the linkages", *op. cit.*, p. 259-(see Table 2) 260.

³³ Smolansky, "Ukraine's quest for independence", *op. cit.*, p. 80.

³⁴ Stern, "The Russian natural gas "bubble", *op. cit.*, p. 60.

³⁵ Fujimori, *op. cit.*, p. 121.

³⁶ "It's a gas: funny business games in the Turkmen-Ukraine gas trade", *Global Witness* (April 2006), p. 33, at http://www.globalwitness.org/sites/default/files/library/its_a_gas_april_2006_lowres.pdf (Accessed on the 23rd January 2014).

³⁷ Stern, "Soviet and Russian gas", *op. cit.*, p. 159. For details of the contract, see: IEA (2006): "Ukraine: Energy Policy Review", p. 219, at

<http://www.iea.org/publications/freepublications/publication/ukraine2006.pdf> (Accessed on the 10th February 2014).

agreement left to contract-based agreements at the companies' level the decision to fix annual amounts and both commercial and technical conditions for transit and export of Russian gas.³⁸

New gas diversions happened in November 1994, initially denied by the Ukrainian side, and then acknowledged the following month, when it was announced that Ukraine had again siphoned off 20% of supplies crossing Ukraine (the second time Ukraine acknowledged such an incident).³⁹ With the replacement of President Leonid Kravchuk by his former Prime Minister, Leonid Kuchma in October 1994, the support of the IMF was sought in order to find a solution with debts to Gazprom in the context of a general involvement of the international organization in the economic reform of Ukraine. As a result, Gazprom agreed to restructure Ukraine's gas debts worth US\$1.4 billion in March 1995 through a special government bond called "Gazpromovok".⁴⁰ This in fact was the prelude to the appearance of gas traders (see below) in the Ukrainian energy market.⁴¹ Two years later, on the 4th December 1996, a new agreement to decide condition of supplies for the next year and the conditions for transit of Russian gas was reached and the transit tariff was set at US\$1.77/tcm/100km.⁴²

Although gas was the main source of trouble, this was not the only one, as oil, the other big energy commodity transported through Ukraine was also at the center of some punctual disputes. As was seen above, Ukraine experienced problems with oil supplies in early 1993⁴³ and would see Russia interrupt supplies in June and July (only resumed in October)⁴⁴ due to the debt accumulated.⁴⁵ As opposed to natural gas, the situation with oil soon turned in Russia's favor. After the initial turmoil, it was agreed that oil would be traded at market prices. As opposed to what has been the norm with gas, that has remained unchanged since then. In 1993 prices for oil were agreed, so Ukraine would pay US\$80/ton in the third quarter, US\$90/ton in the fourth quarter and US\$100/ton in the first quarter of 1994. Ukraine thus soon accepted that oil prices converged towards market prices.⁴⁶ The only point where agreement took more time to come, concerned transit fees as they did not rise to world market levels. This was clearly

³⁸ Malinovskii', Aleksandr; Kurdel'chuk, Daniil and Novak, Inna: Ukraina-Rossia: evropei'skii' podkhod k resheniiu dilemmy na osnove verkhovenstva prava "(Украина—Россия: европейский подход к решению газовой дилеммы на основе верховенства права)", *Zerkalo Nedeli*, 17 December 2005, at http://gazeta.zn.ua/ARCHIVE/ukrainarossiya_evropeyskiy_podhod_k_resheniyu_gazovoy_dilemmy_na_osnove_verhovenstva_prava.html (Accessed on the 1st February 2014).

³⁹ Stern, "The Russian Natural Gas "Bubble", *op. cit.*, p. 60.

⁴⁰ Fujimori, *op. cit.*, p. 122.

⁴¹ *Ibid.*, *Idem.*

⁴² Balmaceda, "Gas, oil and the linkages", *op. cit.*, p. 269.

⁴³ Smolansky, "Ukraine's quest for independence", *op. cit.*, p. 77.

⁴⁴ *Ibid.*, p. 79.

⁴⁵ *Ibid.*, p. 78.

⁴⁶ *Ibid.*, *Idem.*

unfavorable to Ukraine, which was left with transit fees to be agreed bilaterally.⁴⁷ Negotiations where Ukraine sought better terms led to a short disruption in January 1996, when oil flows were stopped for a few hours.⁴⁸ This led Russia to accept de facto higher transit fees.⁴⁹ Since then, oil has been left out of contentious issues.

One option that Russia started voicing from the very beginning and for which it has manifested a clear preference since then, is the creation of gas consortia where both Russian and Ukrainian capital would be involved. This was placed in a more general context of linkage between economics and politics, exemplified by the Russian proposal in September 1993 to cancel Ukrainian debts in exchange for control of the Black Sea Fleet and possession of Ukraine's nuclear warheads inherited from the Soviet army.⁵⁰ Broached as soon as 1993, the idea was revived in negotiations during 1994. The Russian idea was for to obtain 51% for Gazprom in important energy infrastructures.⁵¹ The new company was later brought into being and named as "Gaztransit". The main interest on the part of Russia seemed to obtain a leverage to avoid gas siphoning-off by Ukraine.⁵² However, resistance within Ukraine prevented any deal to be signed, so the project was soon still-born.⁵³

In the meantime, troubles with gas supplies continued, as when in 1997, with Ukraine now mostly depending on Turkmenistan for its supplies (as had been the norm since the year before), the Central Asian republic decided to stop supplies due to a debt of US\$200mill.⁵⁴ Gazprom then stepped in with an offer to increase by 20bcm of gas to compensate.⁵⁵ The year 1997 was a year of general crisis in the energy sector in Ukraine, mostly due to debts that intermediaries had accumulated to the Ukrainian state.⁵⁶ This was coupled with concerns regarding Ukrainian gas storage facilities, which had to be filled enough for the next season. This was not evident in the face of lack of money available to pay for gas on the part of responsible companies.⁵⁷ Besides that, it seems that throughout 1997 UESU and Interhaz had each

⁴⁷ Balmaceda, "Gas, oil and the linkages", *op. cit.*, p. 268.

⁴⁸ *Ibid.*, pp. 268-269.

⁴⁹ *Ibid.*, p. 269.

⁵⁰ Pirani, *op. cit.*, p. 19.

⁵¹ Balmaceda, "Gas, oil and the linkages", *op. cit.*, p. 261.

⁵² *Ibid.*, p. 262.

⁵³ Malygina, Katerina: "Populist games: discourse on domestic gas prices in Ukraine in 2005-2011", 4th ECPR Graduate Conference (4th-6th July 2012), p. 11, at ecpr.eu/Filestore/PaperProposal/1370c79b-13ac-4974-9a41-ad8616eaa525.pdf.

⁵⁴ Turkmenistan would in fact not resume gas exports to Ukraine until January 1999, to be stopped again four months later and then definitively resumed from 2000 through Itera (see: Stern, Jonathan (2005): *The Future of Russian Gas and Gazprom*, Oxford, Oxford University Press, pp. 74-75).

⁵⁵ Smolansky, Oles M.: "Fuel, credit, and trade: Ukraine's economic dependence on Russia", *Problems of Post-Communism*, vol. 46, no. 2 (March/April 1999), pp. 49-50.

⁵⁶ According to Margarita Balmaceda, from August 1996 to July 1997 companies such as UES and Interhaz had a debt to Ukrhazprom of US\$95.3mill for gas transported within Ukraine (see: Balmaceda, "Gas, oil and the linkages", *op. cit.*, p. 275).

⁵⁷ Balmaceda, "Gas, oil and the linkages", *op. cit.*, p. 275.

accumulated around US\$100-US\$120mill owed to Gazprom for supplied gas.⁵⁸ In addition to debts accumulated during 1997, Ukraine had accumulated in the period before a total debt to both Russia and Turkmenistan of as much as US\$4.205bill.⁵⁹

The 1998 agreements seemed to put an end to this period of turmoil.⁶⁰ That year it was agreed that natural gas would cost US\$50tcm. This represented a substantial reduction from US\$80tcm agreed a year before. In parallel, transit tariffs were also reduced from US\$1.75tcm/100km to US\$1.01-1.09tcm/100km. The price of US\$50tcm concerned volumes of natural gas delivered on a market basis, while as much as 30bcm were supposed to be delivered in concept of transit tariff.⁶¹ However, this agreement was illusory, as by late 1998, Gazprom was claiming that gas was again being diverted (as much as 2.5bcm in December).⁶² In the critical context of unpaid bills in Russia and falling exports as a result of the financial crisis of 1998, all the CIS space, including Ukraine, was hard hit. This set the conditions for new gas diversions, unacceptable for Gazprom. After 4bcm were allegedly siphoned off in Ukraine,⁶³ exports of oil, gas and electricity in 1999 were suspended. Gazprom demanded a price of US\$83tcm for these volumes siphoned off and claimed a total debt of US\$2.8bill.⁶⁴ Improvements could have been expected as a result of both the economic stabilization of Ukraine after debt and inflation issues had been solved in the aftermath of the IMF's intervention in the country and the recovery from 1999 of the Russian crisis of the preceding year. However, a factor for Russia's recovery, the world surge in oil prices (from US\$15 per barrel (bbl) in 1998 to over US\$60bbl in 2005)⁶⁵, had the potential to bring troubles for Ukraine, dependent as the country was on Russian gas. With increasing oil prices, Russia was likely to renew pressure on Ukraine to revise prices. In addition to this situation, Russia still needed to recover both debts that had been left aside in the 1998 agreements and new ones that had accumulated since then.⁶⁶ Russia kept complaining about new gas diversions by Ukraine,⁶⁷ which lasted until as late as June 2000. It seems that both unlawful gas diversions in mid-2000 and Russia's efforts to build a bypass through Belarus

⁵⁸ *Ibid.*, *Idem.*

⁵⁹ *Ibid.*, p. 261.

⁶⁰ Pirani, *op. cit.*, p. 21.

⁶¹ Stern, "The future of Russian gas and Gazprom", *op. cit.*, p. 88. As Jonathan Stern points, pricing for Gazprom's gas became somehow irrelevant, as besides deliveries in concept of transit tariff, the rest of the gas was sold from Turkmenistan through intermediaries (at the time, Itera). This was understandable if the gas price reduction matched the reduction in the transit tariff, as this would make changes irrelevant as for gas delivered in concept of transit.

⁶² *Ibid.*, *Idem.*

⁶³ *Ibid.*, p. 89.

⁶⁴ IEA, "Ukraine", *op. cit.*, Box 6.4 "Transit volumes and the debt issue", p. 220.

⁶⁵ Pirani, *op. cit.*, p. 7.

⁶⁶ *Ibid.*, p. 21.

⁶⁷ *Ibid.*, p. 22.

represented the watershed for a real breakthrough.⁶⁸ The acknowledgement by Deputy Prime Minister Oleg Dubina in 2001 of a volume of as much as 8.7bcm of Russian gas siphoned off in 2000 alone,⁶⁹ is a good example of the magnitude of the problem and the dilemma that this supposed for Russian's dependence on Ukraine.

As a consequence of the last stage of turmoil, a new round of agreements from 2000 finally managed to introduce some predictability into Russia-Ukraine energy relations. Some uneventful years ensued until the gas dispute of January 2006. Two agreements, "the agreement on guarantees of transit of Russian natural gas through the territory of Ukraine" from the 22nd December 2000 and the "agreement on additional measures to guarantee the transit of Russian natural gas through the territory of Ukraine" from the 4th October 2001, formed a juridical corpus that would regulate mutual energy relations for the coming years. In exchange for putting an end to gas debts accumulation,⁷⁰ in 2001 Russia confirmed it would continue providing gas for transit and it reserved a maximum of 5bcm to be sold at US\$80tcm in the event of problems with Turkmen deliveries. The transit tariff was set at US\$1.09tcm/100km for both Russian gas to Europe and Turkmen gas to Ukraine.⁷¹ The debt accumulated from the period before was finally agreed to be swapped for gas deliveries in the agreements of August 2004.⁷² Ukraine would thus receive 5bcm less per year for the period 2004-2009.⁷³ That led to a gas deficit which in turn brought some problems the next year as Ukraine lacked enough supplies and had to renegotiate with Gazprom (See chapter 6).

However, the period from 2005 to 2009, coincidental with Viktor Yushchenko's Presidency, ushered the country into a period of increased opposition to Russia. This is when the three big disputes of January 2006 and January 2009 and the minor one of March 2008 took place. The period was far less chaotic than that of the first years of independence reviewed above, but the two aforementioned disputes reached a degree unseen before. Viktor Yushchenko departed from agreements signed in 2004, which opened the door to the creation of an energy consortium in the direction of Russian preferences. Limited as the scope of these agreements might have appeared in the beginning, their cancellation along with the strong and undisguised pro-Western foreign policy choices by the new Administration, set in motion a

⁶⁸ Stern, "The future of Russian gas and Gazprom", *op. cit.*, p. 89.

⁶⁹ Pirani, *op. cit.*, p. 22.

⁷⁰ Ukraine agreed to pay US\$1.43bill. plus US\$200mill. of interest over 13 years, but Gazprom asked for a delay in implementing the agreement for tax reasons (Gazprom would have to pay home taxes on the income); see: IEA, "Ukraine", *op. cit.*, Box 6.4., p. 220.

⁷¹ Stern, "The future of Russian gas and Gazprom", *op. cit.*, pp. 90-91.

⁷² *Ibid.*, p. 92.

⁷³ IEA, "Ukraine", *op. cit.*, Box 6.4., p. 220.

dynamic where Russia probably speeded up the transition to market prices as it intended to demand from all CIS countries. Resisting prices for 2006 at US\$230 as demanded by Gazprom and having closed the door to any scheme involving ownership by Gazprom of Naftohaz infrastructures, Ukraine had to face gas cut-offs from January 1st which were responded by gas diversions that following the same pattern seen in the 90s affected other European consumers. The dispute was solved on 4th January by a complicated arrangement (See chapter 6) expanding the role attributed to the intermediary RosUkrEnergo and through a complex mix of Russian and Central Asian gas (more on this in chapter 6; see below for RosUkrEnergo). The dispute of January 2006 was the first stage in the new period of turbulence, as two new disputes were to hit Ukraine in March 2008 (see chapter 7) and January 2009 (see chapter 8). Ukraine faced a partial cut-off of gas due to debts owed to Gazprom in March 2008 while debt issues again delayed talks on a price agreement for 2009 that eventually led to the biggest dispute ever. With only one day to agree on prices once the debt issue was solved before the midnight deadline and despite close positions between both parts, no agreement could be signed. Ukraine again faced gas cut-offs which translated into new flow disruptions affecting other European customers. With Gazprom then responding with a total gas embargo towards Europe in order to preclude Ukraine making any gas diversions, the dispute lasted a total of three weeks. This provoked a serious energy crisis in some countries like Bulgaria, with a final agreement being signed on 19th January.

With the arrival of Viktor Yanukovich as president of Ukraine, energy relations took a significant turn, leaving behind the tension of the previous years. They did not improve however, to the point of becoming fully cooperative. Tensions remained as the new administration refused to accept Gazprom's wishes for a common management of the transportation facilities through Ukraine. The Kharkiv agreements signed in April 2010 boded well for relations between Russia and Ukraine, as in exchange of the extension of the lease contract for the Russian Black Sea Fleet in the port of Sebastopol, Crimea, to 2042,⁷⁴ Ukraine was granted a further reduction in gas prices (30% from the price agreed in January 2009, instead of 20% had been agreed for 2009).⁷⁵ However, Ukraine balked under Yanukovich at any scheme proposed by Russia involving the figure of a gas consortium or the merging of Naftohaz with Gazprom. The new administration proved thus to be far from a mere pro-Russian stooge as some imagined. Instead, Yanukovich sought instead an active policy of energy diversification. This strategy translated into the import of gas from Poland and Hungary (through the German RWE), the planning of a LNG terminal in

⁷⁴ The lease agreement would expire in 2017. Extended to 2042, the agreements considered the possibility of its being further extended to 2047.

⁷⁵ See: Pirani, Simon; Stern, Jonathan and Yafimava, Katja: "The April 2010 Russo-Ukrainian gas agreement and its implications for Europe", Oxford, Oxford Institute for Energy Studies (June 2010), at <http://www.oxfordenergy.org/pdfs/NG42.pdf>.

the Black Sea and the development of shale gas resources. Meanwhile, Ukraine sought to sign the Association Agreement with the European Union, challenging Russia who wanted Ukraine to join its project of Eurasian Union. Even if economic pressure seemed to be the trigger for the Ukrainian government's rejection of its signature in the Vilnius Summit of the Eastern Partnership, Ukraine signed a new energy agreement on the 17th December 2013 in which Russia offered advantageous gas prices in what looked like an economic concession for political reasons.⁷⁶ As the Yanukovich administration was ousted on the 22nd February 2014 and the country was engulfed in division and civil unrest with the Russian annexation of the Crimean Peninsula and its support to insurrection in Donbass, the future of Russian-Ukrainian energy relations remains as open as gloomy in prospects.⁷⁷ Both the agreements of December 2013 and April 2011 were cancelled and in April 2014 Russia asked Ukraine to pay the price of US\$485/tcm for the second trimester. This disagreement, as well as accumulated debts, led to an energy dispute where gas flows were cut-off from June 16th to early December.⁷⁸ The winter package approved in late October guaranteed the April 2011 discount, so prices remained for Ukraine as before December 2013. To the time of writing, this pricing arrangement has been extended to the second quarter of 2015.⁷⁹

4. 3. The Internal Factor in Russia-Ukraine Energy Relations and Intermediaries

We were able to have a glimpse of the internal market of Ukraine in the previous chapter and see what role corruption played since the beginning. Possibly the best example of the controversial marriage between energy and corruption is the plethora of opaque companies enjoying privileged connections to the government. The chief protagonists in these complex schemes of corruption were the so called "Gazotreidery" or gas traders. That was the name given to these intermediaries when they made their first

⁷⁶ Balmaceda, Margarita: "Will cheap Russian gas save Ukraine?", *Problems of Post-Communism*, vol. 61, no. 1 (March-April 2014), pp. 61-67.

⁷⁷ The new government led by Arsenii Iatseniuk warned in early 2014 that Gazprom would not maintain the reduction in gas prices agreed under the former government ("Rossiia ne dast Ukraine gazovuiu skidku na vtoroi' kvartal - Iatseniuk (Россия не даст Украине газовую скидку на второй квартал - Яценюк)", *Ukrainskaia Pravda*, 3 March 2014, at <http://www.epravda.com.ua/rus/news/2014/03/3/424039/> (Accessed on the 3rd March 2014). In the face of impending increases of prices that Gazprom would link to the existing debt, the Ministry of Energy of Ukraine stated to be ready to refuse any Russian gas in case its prices were too high (see: "dolgoiia tsep' (Долговая цепь)", *Kommersant*, 3 March 2014, at <http://www.kommersant.ua/doc/2421741> (Accessed on the 3rd March 2014). This seems to be technically impossible due to the lack of real alternatives; an important factor to explain how Ukraine "survived" without Russian gas during the gas cut-off that ensued from June to December 2014 is that much Russian gas had been stored already.

⁷⁸ See: Pardo Sauvageot, Eric: "Los juegos del gas entre Rusia y Ucrania: ¿tregua de invierno?", *Eurasianet*, 1 Diciembre 2014, at <http://eurasianet.es/2014/12/los-juegos-del-gas-rusia-ucrania-tregua-de-invierno/#cite=43:1:Osm,43:11:LmF> (Accessed on the 3rd April 2015).

⁷⁹ "Ukraine plans to import Russian gas after \$250 price is confirmed", *Itar-Tass*, 1 April 2015, at <http://tass.ru/en/economy/786466> (Accessed on the 3rd April 2015).

appearance in the 90s. The rationale for their appearance stemmed from the debt problem that marred Russia-Ukraine energy relations. These intermediaries, which were supposed to have at hand the means to recover debts, mainly through barter schemes,⁸⁰ took on a life of their own and started serving their private interests. As Jonathan Stern told *Global Witness* in its report on the Ukrainian energy sector, these companies could enforce commercial conditions that Gazprom was not able to do.⁸¹ Besides that, they often enjoyed better contacts with suppliers who hardly trusted Ukraine as a reliable customer. Hence their (at least apparent) indispensability and the reason for their being able to abuse their position.

The first example of this highly profitable source of revenues was the company Respublika, which came to play a significant role between Turkmen-Ukraine energy relations and which, as seen above, solved a debt dispute between both countries in February 1994. However, Respublika proved a complete disaster and was not up to Turkmen expectations. The main reason lay in the opaque barter system that was thought up in order to organize imports of Turkmen gas. The idea behind it, was very simple: Respublika would pay US\$275mill in money and would then pay the rest of the outstanding debt it had inherited from the government, US\$578mill, in goods, from which 10,000 tons would be in animal fat and 2,000 in baby food.⁸² Problems came when it appeared that Respublika had sold some of the goods well over its real market value.⁸³ Respublika was eventually removed from the energy trade with Turkmenistan and a replacement had to be found to solve the still unsolved debt with the Central Asian producer.

The next solution came with the appearance of a second company, Itera, which would prove much more resilient after the false start of Respublika. Itera stayed in business from 1994 to 2002. The origins of Itera, headed by Igor Makarov, owed something both to Turkmenistan and to Gazprom. Igor Makarov himself was a resident in Turkmenistan who had made a business out of selling food for oil in that country thanks to his close relations to high ranking people in the circle of power in Ashgabad,⁸⁴ as can be exemplified by the fact that former Vice-President from 1989 to 1991, Valery Otchertsov, was to become Vice-President of Itera.⁸⁵ Gazprom's role was clear when the joint venture "TurkmenRosGas" was terminated in 1996 amid allegations from the Turkmen government that Itera owed US\$200mill. As could

⁸⁰ "It's a gas", *op cit.*, p. 32.

⁸¹ *Ibid.*, *Idem.*; what was meant in this sense is that unlike Gazprom, these companies were private entities which could exert pressure on consumers who refused to fulfill payments without triggering any diplomatic crisis between Russia and Ukraine.

⁸² *Ibid.*, p. 33.

⁸³ *Ibid.*, *Idem.*

⁸⁴ *Ibid.*, pp. 33-34.

⁸⁵ As *Global Witness* shows, the role of Otchertsov was important for Itera, as he was one of the main hands behind the constitution of the company "TurkmenRosGas" in August 1996, a company which was composed by the Turkmen state with 51%, Gazprom with 45% and Itera itself with the remaining 4% (see: "It's a gas", *op cit.*, p. 34).

have been expected after the fiasco of Respublika, Turkmenistan wanted to put an end to Itera's presence and called for direct sales without intermediaries.⁸⁶ Gazprom however, had other intentions and lobbied in favor of Makarov's company. As Makarov himself explained, Itera had the wherewithal through its complex barter scheme and could get payments from Ukraine.⁸⁷ That could provide an explanation for Gazprom's insistence. Irrespective of whether that was true or not, the fact is that Gazprom's support for Itera, a company that looked more like a competitor than an ally and from which it bought Turkmen gas at higher prices than if it had purchased them directly,⁸⁸ had also much to do with corruption and the interest of its head, Rem Vyakhirev, to channel funds away from the company for personal enrichment. Indeed to some, the way Itera was favored, with as much as 50% of Gazprom's former markets in the post-Soviet space surrendered to the intermediary,⁸⁹ could not be explained just by a strategic interest in Makarov's company.⁹⁰ Suspicion that some of Gazprom's officials had a personal interest in the company increased when it was revealed through an audit in April 2001 that some undisclosed individuals owned shares of the company.⁹¹ But Itera did not profit only at the expense of Gazprom's corporative interests (and of Turkmenistan's possibly too), but also of Ukraine. For example, it extracted money at the expense of its consumers by declaring inflated prices in order to seek state reimbursements and cash in more profits. The way for this was paying a reduced cash price to Gazprom for the use of pipelines it owned and then asking for a "reimbursement" from Ukraine. This reimbursement was made in gas that was then sold abroad at higher prices.⁹²

However, Itera had its days numbered. The Russian side eventually dumped it, sealing its fate as intermediary with Ukraine and opening the door to another company, EuralTransGaz (ETG). The reason for Itera's disgracing had much to do with the arrival of Vladimir Putin as President of the Russian

⁸⁶ *Ibid.*, p. 34.

⁸⁷ *Ibid.*, *Idem*.

⁸⁸ *Ibid.*, p. 35: in the year 2000 for example, Itera bought Turkmen gas at the price of US\$35.35tcm and sold a third thereof to Gazprom at US\$45tcm, or even US\$50tcm if we are to trust other sources from Gazprom itself. This means that Itera was making windfall profits at the expense of the Russian gas monopoly. Gazprom's explanation that the difference came from transporting costs was not credible, as it seems that these were reimbursed apart in virtue of another contract (see: *Ibid.*, *Idem*).

⁸⁹ *Ibid.*, *Idem*.

⁹⁰ In the specific case of Ukraine, Itera had a bigger share of gas sold to Ukraine from 1999 to 2002 (See: Stern, "The future of Russian gas and Gazprom", *op. cit.*, Table 2.2, p. 69).

⁹¹ "It's a gas", *op. cit.*, p. 36: Makarov was the direct owner of 26% of the company through "Itera Group NV", while other individuals held as much as 13%; the remaining 61% belonged to two trusts for top managers and employees whose identities could not be disclosed. Further details unveiled two years later, in March 2003, showed that Makarov seemed to have increased his ownership to 46%, while Otchersov was owner of 7% of the company's shares (see: *Ibid.*, *Idem*).

⁹² Balmaceda, Margarita: "Ukraine's persistent energy crisis", *Problems of Post-Communism*, vol. 51, no. 4 (July/August 2004), p. 42. As Jonathan Stern had written in 2005, the audit by PwC in 2001 did not prove any explicit wrongdoing from the side of Itera and Gazprom, even if the fact that members of Gazprom's management owned shares raised justified suspicions. Itera was on its way to become a "respectable" company when the European Union ensured increased gas supplies for Ukraine in exchange for the closing of Chernobyl in an agreement where Brussels itself was involved (see: Stern, "The future of Russian gas and Gazprom", *op. cit.*, p. 23).

Federation and with changes in Gazprom's management. This started with the substitution of Rem Viakhirev by the trusted Alexei Miller in 2001, who then gradually consolidated his power until the state became majority share-holder in 2004. Deputy chairman of Gazprom, Alexandr Riazanov, voiced concerns regarding Itera and called for its substitution by Gazprom itself, as it could perfectly fulfill the same duties without intermediaries.⁹³ Itera's removal was apparently also desired in Ukraine.⁹⁴ The next step, that of establishing a joint venture between Gazprom and Naftohaz seemed to be the most reasonable, as they had a common interest in ensuring Turkmen gas's uneventful transit. The new intermediary would start working from the 1st January 2003. However, the end result eventually ended up following the same pattern as with its predecessors. The involvement of opaque third parties happened again with EuralTransGaz.

The origins of EuralTransGaz were shrouded in mystery and its owners mostly unknown until the controversial composition came to light in scandal. Even if the original intent was to have the company as a joint venture between the two state companies, it ended up being the exact opposite, as opaque offshore companies came to form the core instead. The company was headed by the obscure former KGB member, the Hungarian Andras Knopp and had been registered by the Israeli lawyer Zeev Gordon. The latter admitted having received the demand for registration by a Ukrainian businessman called Dmitro Firtash.⁹⁵ Surprisingly, it appeared that the shares owned by Zeev Gordon had been transferred to three Romanian citizens, simple private persons that were promised money in exchange for lending their signatures.⁹⁶ Both Knopp's and Boi'ko's (Iurii Boi'ko was then Head of Naftohaz) interviews in 2003 hinted at EuralTransGaz being a transitory solution while a new company was discussed.⁹⁷ By April 2004 the situation regarding EuralTransGaz became more confused and Naftohaz and Gazprom still remained out of the company's opaque ownership structure. The structure of EuralTransGaz at that time was the following: a British company, Atlantic Caspian Resources, became the owner of 44.67% of the shares, a Dutch company called JKK Gas BV came to possess 30%, while the rest of the shares amounting to 25.33% ended in the hands of an Austrian firm known as DEG Handels. Behind two of these companies

⁹³ "It's a gas", *op cit.*, p. 36. Itera was systematically driven out from most of the market niches it had managed to settle itself: it had first to return its 32% of stakes in Purgaz and 51% in Severneftegazprom; then from 2002 Itera started facing restrictions to sell gas in the CIS region and to use Gazprom's pipeline system, having to relinquish its role as shipper of Central Asian gas to EuralTranzGaz (see below) in December 2002; a limitation from 2003 (and eventual suppression from 2004) of Turkmen gas exports through Uzbekistan was announced in July 2003, leaving Itera without any Central Asian natural gas; then Gazprom restricted any sale of gas in the Trans-Caucasus region; finally, left only with the field of Beregovoe in Western Siberia, Itera saw the transport from this field limited by Gazprom (see, Stern, *op. cit.*, pp. 24-25).

⁹⁴ "It's a gas", *op cit.*, p. 36.

⁹⁵ *Ibid.*, p. 37.

⁹⁶ *Ibid.*, p. 38.

⁹⁷ *Ibid.*, p. 39.

appeared two companies from Cyprus, "Dema Trustees Limited" and "Dema Nominees Limited".⁹⁸ The biggest question, which *Global Witness* dealt with, was to show whom benefits of the company accrued and why did Naftohaz and Gazprom shun benefits and leave the business to an apparently useless intermediary.⁹⁹ The contract with EuralTransGaz was terminated in 2004 without apparent reasons, but as Zeev Gordon himself argued afterwards, this was the result of the bad publicity the company was receiving after details on its ownership structure were filtered.¹⁰⁰ It has also been suggested this might only have been the trigger for an impending decision from the part of Gazprom, dissatisfied with an arrangement which made it incur significant losses.¹⁰¹ Whatever the reason, EuralTransGaz was terminated and substituted by another company called RosUkrEnergo. This would prove the apex in the trail of scandals initiated by its predecessors. Besides its murky nature, what definitely set RosUkrEnergo apart from previous companies was the shadow it cast on the biggest gas disputes ever: that of January 2006 and also, at least in part, that of January 2009. In both disputes RosUkrEnergo became the third actor apart from Russia and Ukraine.

RosUkrEnergo started as a more promising formula though. As opposed to previous schemes involving only private individuals and in the same way Gazprom seemed to have been insisting before, the Russian gas monopoly became 50% owner of the company. The exact ownership was not devoid of controversy though, as instead of direct ownership, Gazprombank owned its shares through the company "ArosGas Holding AG",¹⁰² and through a long list of offshore intermediaries not "simplified" before December 2006.¹⁰³ The stability of Gazprom's presence was hampered by the opacity that characterized the other half of RosUkrEnergo. This other half was owned by "CentraGas Holding AG", a subsidiary of the Austrian based "Raiffeisen Investment". Of this second half the only known fact was that the owners were Ukrainian businessmen. Their identity however, was not disclosed.¹⁰⁴ Agreed in July 2004, the company started working in 2005 exporting Turkmen gas to Ukraine and retaining an important share of gas in payment of the transit tariff, from which part was resold to Ukraine (to be then resold to Europe at market prices) and the rest remained in its hands to be sold in Central Europe, from where it made big profits. The issue of ownership came to the forefront after the resolution of the gas dispute of January

⁹⁸ *Ibid.*, p. 41; for more details on the exact ownership of the complex webs of owners of EuralTransGas, see: *Ibid.*, pp. 42-46.

⁹⁹ EuralTransGas neither brought capital, infrastructure nor gas reserves prior to being empowered by Russia and Ukraine.

¹⁰⁰ "It's a gas", *op cit.*, p. 48.

¹⁰¹ *Ibid.*, *Idem.*

¹⁰² *Ibid.*, p. 49.

¹⁰³ After the many questions that the upgraded role of RosUkrEnergo (RUE) after the January 2006 dispute raised and after the secretive company's ownership was fully revealed, it seems Gazprom bought Gazprombank's shares and brought them under its direct control. This was done either as a cosmetic change to dispel doubts or as a real effort to bring the company under tighter control. This will be dealt with in further detail in chapter 6.

¹⁰⁴ "It's a gas", *op cit.*, p. 49.

2006 (see chapter 6) expanded the role of RosUkrEnergo. As a result of this, RosUkrEnergo came to monopolize the whole gas mix of Ukraine, made of Central Asian (mainly Turkmen, but also Uzbek and Kazakh) and Russian gas and many in Ukraine raised the alarm as for the possible interests Gazprom may have had at involving RosUkrEnergo in the resolution of the dispute. The fact that besides its bigger share of natural gas to be sold to Ukraine, RosUkrEnergo would also constitute in parity with Naftohaz a new company, UkrGazEnergo and which would henceforth monopolize gas imports in the domestic Ukrainian market, represented a proof for many that Gazprom was trying to penetrate Ukrainian gas market in order to gain ownership as it had always tried since the 90s. In this narrative, these changes were related to the financial situation of Naftohaz, which would probably worsen as a result of the prohibition to re-export gas in Europe included in the January agreement. This was seen as a way to bankrupt the company and leave the path open to Gazprom's "financial rescue". The fact that only the ownership of Gazprom was known, probably reinforced the impression that RosUkrEnergo was nothing more than a pawn serving Vladimir Putin's interests. However, when it was revealed that the owners of CentraGas were Dmitro Firtash (90%) and Ivan Fursin (10%), the former having been also involved in the constitution of EuralTransGaz and close not only to one of the most influential personalities of the politicians in the Party of Regions,¹⁰⁵ Iurii' Boiko,¹⁰⁶ but also rumored to be on good terms with the new President Viktor Yushchenko.¹⁰⁷ As *Global Witness* delved more deeply into the details, it was revealed that many were the links between EuralTransGaz and RosUkrEnergo: "DEG Handels" and CentraGas had the same address in Vienna; one of its executives, Sabine Penkler, was on the supervisory board of "Ostchem Holding AG", not only at the same address too, but as we know in retrospective, one of Mr. Firtash's main

¹⁰⁵ The Party of Regions, based in the industrial region of Donetsk, related to the homonymous oligarchy and presumed to have its main businessman, Rinat Akhmetov, as the driving force of the party, supported Viktor Yanukovich as presidential candidate in 2004 and 2009, and has been the ruling party from March 2006 to October 2007 and since 2010 until the Euromaidan.

¹⁰⁶ As *Global Witness* explained, Boi'ko was one of the driving forces in the creation of RosUkrEnergo and was one of the two representatives that Naftohaz had sent to its coordinating committee along with Igor Voronin (*Ibid.*, p. 52). As *Global Witness* pointed to, this situation was odd and represented a clear conflict of interests, as Naftohaz did not have formal ownership and still, was representing unknown private interests (see: *Ibid.*, *Idem*). According to this source, these two individuals would have stepped down one year later in June 2005 (see: *Ibid.*, p. 54).

¹⁰⁷ These rumours started surfacing in mid-2005 as the new government by Yulia Tymoshenko intended to take on RosUkrEnergo as chief representative of the opaque and corrupt business interests related to the former Administration of Leonid Kuchma. Apparently, efforts by the Head of the Security Services of Ukraine (SBU), Oleg Turchynov to investigate the true nature of RosUkrEnergo were repeatedly thwarted by the Presidential Administration, with the president himself presumed to have demanded not to "persecute his people", an unfortunate phrase that has been used as anecdotal proof of his personal interests. As for the minor partner, Ivan Fursin, there are business connections that could also reveal a connection to the president: he was connected to the Syrian born Yussef Hares, linked himself to Firtash too, but also politically close to the president himself. In addition to that, the leader of the Communist Party, Petro Simonenko, accused the president in early 2008 of being connected to UkrGazEnergo through his brother Petro Yushchenko, who some rumours point to as a recipient of obscure payments by RosUkrEnergo on the 3rd January 2006 (one day before the agreement that put an end to the dispute) through the company "PetroGas" (this will be dealt with again in chapter 6).

companies;¹⁰⁸ Wolfgang Putschek, representative in the Coordinating Committee of RosUkrEnergo in representation of Raiffeisen, was a member of a company called "Ostchem Trading"; Robert Shetler-Jones, who had an important role in EuralTransGaz, was one of the four representatives on the same committee on behalf of EuralTransGaz; Raiffeisen Investment had bought in September 2003 54% of Rivneazot, a company which was also related to Firtash through its company Nitrofert.¹⁰⁹

RosUkrEnergo soon fell out with both the Ukrainian and with the Russian side, especially when Timoshenko came back as Prime Minister in December 2007 and made of the suppression of RosUkrEnergo's presence in the Ukrainian energy market one of her prime objectives. After the dispute of March 2008 (see chapter 7), both Kiev and Moscow agreed to do without the company for 2009, and indeed, as the 19th January 2009 agreement was signed putting an end to the latest dispute (see chapter 8), RosUkrEnergo disappeared from the scene. With the latest revision of Russia-Ukraine's energy relations, the saga of intermediaries which started with Respublika back in the turmoil of the 90s came to its final end. However, RosUkrEnergo did not leave without scandal. Although there has not been final confirmation thereof, there are allegations that the company was at the center of the trigger that derailed conversations on a new contract for 2009 that until the very end seemed to have a certain potential for success. When negotiators from Naftohaz and Gazprom were trying to finalize a late-hour agreement for a contract and thus avoid impending gas cut-offs, it seems that positions were not quite far from each other, with Gazprom insisting on US\$250tcm while Naftohaz preferred a slightly lower price of US\$235tcm. This is the moment when the Russian side would have received an offer from RosUkrEnergo of as much as US\$285tcm. This could have been understood as a desperate effort from the intermediary to stay in business and to avert its suppression. This offer would have incensed Prime Minister Putin personally, suspecting the Ukrainian negotiators of absolute duplicity and as a consequence conversations were immediately ended.¹¹⁰

Since then, schemes involving intermediaries as seen above have not been resurrected. RosUkrEnergo resurfaced in 2010 when the Stockholm Arbitration Court ruled in favor of this company in its allegations that Naftohaz had illegally seized volumes of gas located in storage facilities amounting

¹⁰⁸ Ostchem started importing first Turkmen gas (from Gazprom) and then exclusively Russian gas from 2011, when the monopoly on imports by Naftogaz was cancelled. This continued until 2013, as thereafter Yanukovich was ousted through the Euromaidan. An investigation by *Reuters* claimed that far from being initially favored by reduced prices on Turkmen gas, OstChem was favored during the whole period, with Gazprom voluntarily losing as much as US\$2bill (see: Grey, Stephen and Bergin, Tom: "Putin's allies channelled billions to oligarch who backed pro-Russian president of Ukraine", *Reuters*, 26 November 2014, at <http://www.reuters.com/investigates/special-report/comrade-capitalism-the-kiev-connection/> (Accessed on the 24th April 2015)).

¹⁰⁹ *Ibid.*, pp. 54-56

¹¹⁰ More details on this obscure episode will be discussed in chapter 8.

to as much as 11bcm in January 2009.¹¹¹ This temporarily restored RosUkrEnergo as a gas trader, although this was nothing more than a belated consequence of the company's earlier role. However, the new situation derived from the January 2009 agreement did not just restore Naftohaz as the only gas importer. In 2011 legal changes in Ukraine opened the door for new private companies to import gas to Ukraine directly without intermediation of Naftohaz. This promised to greatly modify the picture of the energy sector in Ukraine and had also the potential to affect energy relations between Russia and Ukraine. The biggest beneficiary was the company Ostchem, which started importing gas from the fourth quarter of 2011 and remained active until 2013. As this company belonged to Firtash, it would seem reasonable to imagine that the Yanukovich administration had restored a close oligarch into the gas trade at the expense of the state. This could also feed rumours that always identified Firtash with Russian interests. The fact that Ostchem started importing cheaper gas from Central Asian would lend credence to the narrative of Firtash as close partner to Gazprom. From 2012, Gazprom ceased exporting Central Asian gas and started selling Russian gas instead, thus, seemingly ending the short lived policy of favoring Ostchem,¹¹² even if recent information (see ft. 108) points out that favorable prices continued. A new actor entered the stage, VETEK, owned by Serhyi' Kurchenko and closely aligned with the business interests of Yanukovich's close circle. This company has been importing Russian gas sold in reverse mode from Germany. Another actor that was rumored to be entering the market of gas imports was DTEK, owned by the richest oligarch in Ukraine, Rinat Akhmetov.

With Yanukovich toppled, the energy panorama underwent important changes, with the oligarch's balance within the country, changing radically. Dmitro Firtash was arrested in Vienna on the 13th March 2014 as a result of a request by the FBI¹¹³ and Serhyi' Kurchenko's businesses are being investigated for

¹¹¹ "Stockholm arbitration rules in favor of RosUkrEnergo", *Kyiv Post*, 9 June 2010, at <https://www.kyivpost.com/content/ukraine/stockholm-arbitration-rules-in-favor-of-rosukrener-69079.html> (Accessed on the 3rd March 2014).

¹¹² Nothing conclusive can be said at this stage regarding the reasons for Gazprom's treatment of favor to Ostchem in its first deliveries of gas in late 2011. A possible explanation, that can unfortunately only remain in the realm of hypotheses, could relate this improvement in relations between Gazprom and Ostchem to the obscure fight that both were waging in Hungary for the control of the company Emfesz: RosUkrEnergo, owner of the Hungarian company since 2003, was challenged by a controversial takeover in 2009 by the mostly unknown RosGas Ag, which was supposedly controlled by Gazprom (For details of this saga, see: "More funny business in Europe's gas trade", *Global Witness*, Briefing (May 2009), at http://www.globalwitness.org/sites/default/files/import/gw_emfesz_may09.pdf (accessed on the 3rd March 2014). This background along the volumes of gas that RosUkrEnergo recovered in 2010 and that could be sold in Central and Eastern Europe in competition against Gazprom could have influenced both Gazprom to agree with Firtash on a status quo; cheap gas from Central Asian could have been part of this thaw, which would have soon unraveled the following year.

¹¹³ Leshchenko, Sergei': "Firtash ide na posadku (Фірташ іде на посадку)", *Ukrainska Pravda*, 14th March 2014, at <http://www.pravda.com.ua/rus/articles/2014/03/14/7018722/> (Accessed on the 14th March 2014). The question remains whether the decision coming from the US is politically motivated. That this happened few weeks after the opposition came back to power and amid suspicions that this might be the consequence of intra-fighting among opposition forces strongly supports such assumptions (see the very interest analysis in Spanish by Íñigo Sáenz de Ugarte: "EEUU saca del juego a un

tax evasion. None of these two oligarchs, so prominent in the years before will probably be able to pay a significant role in the new period, at least in the short term.

oligarca ucraniano y rival de Timoshenko", *Blog Guerra Eterna*, 13th March 2014, at <http://www.guerraeterna.com/firtash/> (Accessed on the 14th March 2014) and "Timoshenko y el baile de los oligarcas en Ucrania", *Blog Guerra Eterna*, 12^{ve} March 2014, at <http://www.guerraeterna.com/timoshenko-y-el-baile-de-los-oligarcas-en-ucrania/> (Accessed on the 14th March 2014). Many rumours linked Firtash to UDAR, Vitaly Klichko's party, as one of its financiers. With Klichko (along with Petro Poroshenko) ahead of Timoshenko in polls, and in any case beating her in the second run (see: "Timoshenko v sluchae uchastiia v presidentskikh vyborakh mozhet vyiti vo vtoroi' tur i sostavit konkurenstiiu Klichko i Poroshenko - opros (Тимошенко в случае участия в президентских выборах может выйти во второй тур и составить конкуренцию Кличко и Порошенко – опрос)", *Interfax*, 12^{ve} March 2014, at <http://interfax.com.ua/news/political/195566.html> (Accessed on the 14th March 2014) and Ivzhenko, Tat'iana: "Vybory prezidenta Nezalezhnoi' mogut perenesti na dekabr'" (Выборы президента Незалежной могут перенести на декабрь)", *Nezavisimaia Gazeta*, 14 March 2014, at http://www.ng.ru/cis/2014-03-14/1_ukraina.html (Accessed on the 14th March 2014), there seems to be reasons for suspecting obscure interests (besides the fact that Firtash is one of the persons most loathed by Timoshenko). As the unfortunate comments by Victoria Nuland, Assistant Secretary of State for European and Eurasian Affairs at the United States Department of State and which were leaked (presumably by Russian secret services) showed, Vitaly Klichko did not seem to be the US sponsored candidate. In the presidential elections celebrated in May 2014, Petro Poroshenko won in the first tour.

Chapter 5: Russian Relations to Europe and the Energy Factor

5. 1. Soviet Energy Relations with Europe in the Context of the Cold War

Since the onset of the Cold War, Eastern and Western Europe remained separated to a degree not seen before. This obviously affected economic relations, even if these were far from severed in spite of the rivalry between the two blocs. The importance of economic relations was manifest during the whole period where the Cold War imposed its political logic; economic relations were seen either as a positive inducement to ease tension, or on the contrary, trade restrictions as a vital tool to weaken the opponent.¹ Apart from that, quite often Western European countries simply considered the short-term benefits that trade might bring and clashed with the US who usually supported a more hard-line agenda.² As it might seem evident, energy figured from the very beginning as a key item in this respect. Besides its contentious dimension, energy trade between the Soviet Union and Western Europe was inaugurated at this time, starting a trend which as will be seen, has continued until now.

The first export pipeline project from the Soviet Union with financial involvement from Western Europe³ was the "Druzhba (Friendship)" pipeline, whose construction started in the early 60s.⁴ Before that, the Soviet Union had already started selling oil to Western Europe by tanker, mainly to Italy's ENI in the 50s.⁵ This had raised the first alarms among those fearing increased Soviet influence and the possibility of seeing the Western alliance split. The Soviet Union was conscious of the need for hard currency if Nikita Khrushchev intended to raise the quality of life and import both industrial and consumer goods from the West, as well as to soften containment and help his policy of Peaceful Coexistence.⁶ The US managed eventually to reduce Italy's dependence on Soviet oil from 22% in 1962 to 10% three years later⁷ and also successfully influenced West Germany (as well as Italy and Japan)⁸ not to sell steel

¹ As Robert Jentleson puts it: "in the broadest sense the dispute has been over whether détente and defense are complementary or contradictory strategies for relations with the Soviet Union" (see: Jentleson, Robert (1986): *Pipeline Politics: East-West relations*, Ithaca; London, Cornell University, p. 37).

² For the tension between the US and its Western allies regarding trade with the Communist bloc, see: Mastanduno, Michael (1992): *Economic containment: CoCom and the politics of East-West trade*, Ithaca; London, Cornell University.

³ Western companies committed to the project for providing wide-diameter pipes were the target of US pressure and had to withdraw, with the Soviet Union having to assume its construction; some of the volumes of oil were to be re-exported to Western Europe (see: Jentleson, Bruce W.: "Khrushchev's oil and Brezhnev's natural gas pipelines", in Lieber, Robert J. (ed.) (1983): *Will Europe fight for oil? Energy relations in the Atlantic area*, New York, Praeger, pp. 40-42).

⁴ Jentleson, *op. cit.*, p. 22, 97-98, 104.

⁵ See: Votaw, Dow (1964): *The six-legged dog: Mattei and ENI--a study in power*, Berkeley, University of California Press and Frankel, Paul H. (1966): *Mattei; oil and power politics*, New York, Praeger.

⁶ Jentleson, *op. cit.*, p. 85.

⁷ *Ibid.*, p. 112.

⁸ *Ibid.*, p. 118.

pipelines needed for the construction of the "Druzhba" pipeline.⁹ However, the trend for increased trade with the Soviet Union could not be stemmed. Figures were already going upwards from the mid-60s and this trend was reinforced in the 70s in the midst of Détente and Ostpolitik. In this context, as could have been expected, energy projects figured highly.

The idea of developing a gas pipeline to export natural gas to Europe came to substitute the initial project (known as "North Star") of exporting LNG to the US, and soon promised to nurture high-scale energy projects. Russian natural gas, an advantageous resource after oil prices jumped in 1973, was the object, two years later, of a trilateral swap agreement by France, West Germany and Austria with Iran and the Soviet Union. This agreement, though, was eventually cancelled due to the Iranian revolution.¹⁰ However, before this project started being planned, Austria had already become the first recipient of small amounts of gas, soon to be followed in 1974 by West Germany and Italy.¹¹ With oil prices soaring in 1979, Soviet natural gas could only be more coveted in Western Europe. This led to the so called "East-West" pipeline deal,¹² which foresaw that the Soviet share in the global natural gas consumption of Germany and France would jump from 15% and 11.7% in 1980 to almost 30% ten years later, while Italy might by that time have reached as much as 40%.¹³ European countries interested in Soviet gas ended up committing to 25-30 bcm, 10-15 less than initially intended,¹⁴ this being caused more by decreasing oil prices and the persistence of economic stagnation, which reduced the need for Soviet gas,¹⁵ and less by American pressure,¹⁶ which utterly failed to force the cancelation of contracts.¹⁷

⁹ *Ibid.*, pp. 116-118.

¹⁰ *Ibid.*, p. 166.

¹¹ Stern, Jonathan P.: "Soviet natural gas in the world economy", in Jensen, Robert G.; Shabad, Theodore and Wright, Arthur W. (1983): *Soviet natural resources in the world economy*, Chicago, University of Chicago Press, p. 372-373, Austria and Italy were served through the small pipeline "Trans Austria Gas" while the MEGAL pipelines also served Austria in addition to West Germany and France (see: Lévêque et al. (ed.) (2010): *Security of energy supply in Europe: natural gas, nuclear and hydrogen*, Cheltenham, UK; Northampton, MA, Edward Elgar, p. 29.

¹² This pipeline was often called "Yamal" during the early 80s, as it was supposed that natural gas would come from the field of Yamburg, in the Yamal peninsula (Gustafson, Thane (1989): *Crisis amid plenty: the politics of Soviet energy under Brezhnev and Gorbachev*, Princeton, Rand Corporation; Oxford, Princeton University Press, p. 162). However, the so-called "gas campaign" in the early 80s, meant to increase gas production to offset feared oil depletion rates, prioritized a rapid increase in output, so the field of Urengoy was exploited at a faster rate (*Ibid.*, p. 163); this became the source for the "East-West pipeline", which received the technical name of Urengoy-Uzhgorod (Ukraine). A so called "Yamal pipeline" was built in the late 90s and transports gas through Belarus.

¹³ Jentleson, *op. cit.*, p. 185.

¹⁴ *Ibid.*, p. 199 (to see the complex negotiations on prices and volumes and the subsequent changes favored by Western European partners: Gustafson, Thane: "Soviet negotiating strategy: the East-West pipeline deal, 1980-1984", Rand Corporation (February 1985), at <http://www.rand.org/content/dam/rand/pubs/reports/2007/R3220.pdf>, pp. 29-34).

¹⁵ *Ibid.*, p. 200.

¹⁶ Bruce Jentleson argues that reductions in gas imports were distributed among all sources, which belies the assumption that economic factors were influential; in fact, West Germany proportionally reduced Soviet gas imports less than other sources (*Ibid.*, p. 201).

However, it cannot be forgotten that energy was as much a tool to trade with Western Europe as a precious instrument to cement relations between the Soviet Union and the satellite communist regimes in Central Europe that Moscow imposed after World War II. Pipelines transporting oil and natural gas were first built to guarantee energy needs for these countries; while contracts were not favorable for the Soviet Union in economic terms,¹⁸ these secured political allegiance.¹⁹ The importance of Soviet oil and gas for the Central European economies was crucial: the rates of dependence for petroleum in 1965 represented as much as 88% (excluding Romania); ten years later, they reached a staggering 96% (75% including Romania), whereas in 1989, at the eve of the collapse of communism, dependence remained at 81%.²⁰ Regarding natural gas, this commodity followed a similar path: dependence on Soviet resources climbed to 50% in 1989 from a meagre 6% in 1970.²¹

The first common project among countries of the CMEA was the construction of the oil pipeline "Druzhba", already mentioned above and which was agreed in 1958.²² Then natural gas would soon follow with the signature in the mid-60s of the pipeline "Bratstvo"²³ (Central European countries like Czechoslovakia became useful outlets for gas to Western Europe, as happened with the project "Transgaz" agreed in 1970 and which would branch out to neighboring Austria)²⁴. Natural gas projects expanded in the 1970s with the development of the "Soyuz" project (Soyuz or Orenburg pipeline) which would deliver gas both to Western parts of the Soviet Union and to those CMEA countries involved in the

¹⁷ For a detailed account of the episode of pressure from the Reagan Administration on France, UK, West Germany and Italy to cancel the contracts, see: Blinken, Anthony J. (1987): *Ally versus Ally: America, Europe and the Siberian pipeline crisis*, New York; Westport, Connecticut; London, Praeger; this is also dealt with in: Stein, Jonathan B. (1983): *The Soviet bloc, energy, and Western security*, Lexington, Massachusetts, Lexington Books, Chapter 4, pp. 59-84; Gustafson, "Soviet negotiating strategy", *op. cit.*

¹⁸ Reisinger, William M. (1992): *Energy and the Soviet bloc: alliance politics after Stalin*, Ithaca, Cornell University Press, pp. 13-14.

¹⁹ This happened in two ways: loyal countries like Bulgaria and the GDR (the latter having a particular strategic importance and an advantageous position as a door to Western economic resources) received advantageous prices, whereas other loyal members of the Warsaw Pact such as Czechoslovakia, were also "rewarded" (see: Reisinger, *op. cit.*, pp. 6-7, 77). On the contrary, countries like Poland, Hungary and Romania who often (in particular the latter) tried to strike a more autonomous course, were somewhat penalized as compared to loyal members (see: *Ibid.*, pp. 7-9). Besides receiving favorable treatment with regard to prices, countries favored were also given enough imports to close up their energy needs, and often in excess as to re-export (*Ibid.*, pp. 75-76). "Loyalty" and therefore advantages in energy trade, correlated with bigger defense spending per GNP (see: *Ibid.*, pp. 91-93). Besides that, as could have been expected, ensuring the country's stability in the face of unrest was also a reason for the Soviet Union to agree to more favorable terms, as was the case of Poland in the first part of the 80s (*Ibid.*, p. 77), or the case of Czechoslovakia, where after 1968 and the Velvet Revolution, conditions improved while expenses on defense decreased (*Ibid.*, p. 104).

²⁰ *Ibid.*, pp. 17-19.

²¹ *Ibid.*, p. 19.

²² *Ibid.*, pp. 39-40.

²³ *Ibid.* p. 45.

²⁴ *Ibid.*, pp. 49-50; during that period Eastern European countries (mainly Czechoslovakia and the GDR) started exporting gas themselves through agreements with the Soviet Union where they would receive gas for their disposal in exchange for helping in exploiting fields on Russian soil (*Ibid.*, p. 50-51).

project.²⁵ It also involved Western companies which supplied materials for construction,²⁶ with part of the natural gas being sold to Western Europe in exchange.²⁷ Through this project, gas serving the new pipeline came to represent 17% of all gas consumed by the CMEA countries in 1980.²⁸ In a development which would have a great impact on the fuel share of the Central European Republics until now, and which would materialize in its worse dimension during the gas disputes of 2006 and 2009, the Soviet Union insisted in the 80s on increasing the share of natural gas in substitution of oil in its trade with the CMEA countries.²⁹ This policy of oil substitution for gas was also applied in the Soviet Union itself.³⁰ The reason for imposing this policy was simple: in the 70s, the Soviet Union feared that oil production might not increase adequately.³¹ Precisely, oil became in this decade a vital commodity for the Soviet Union and helped avert a collapse of its economic system, as it enabled the import of agricultural products necessary to make up for low internal production. If initial plans involved an increased use of coal, it finally became easier to concentrate gas for internal consumption to free up as much oil as possible.³²

5. 2. Russian Energy in Europe after the Collapse of the Soviet Union

Due to the high proportion of coal in their energy mixes,³³ the energy transition that Central European countries undertook after the fall of communism and the reduced consumption of solid fuels could only benefit Russia as an oil and gas producer. In the first years after the fall of communism though, economic slowdown and deindustrialization reduced the consumption of oil in former CMEA countries. However, even reduced consumption did not offset for Russia the benefit of receiving US dollars in exchange for trade with Central European countries.³⁴ Thus, benefits could be found even in a context of halved output in the first half of the 90s as a consequence of the Soviet Union's collapse. However, the gradual expansion of the European Union, which translated into the accession in 2004 of 10 countries, most of

²⁵ *Ibid.*, pp. 53-54; these other additional projects to link up with Soyuz would see the light one decade later, with the gas pipeline "Progress" (see: *Ibid.*, p. 64).

²⁶ Stern, *op. cit.*, p. 373.

²⁷ OTA (1981): *Technology and Soviet energy availability*, Washington, D.C., Congress of the U.S., Office of Technology Assessment, p. 26.

²⁸ Stein, Jonathan B. (1983): *The Soviet bloc, energy, and western security*, Lexington, Massachusetts, Lexington Books, p. 38.

²⁹ Reisinger, "Soviet natural gas", p. 63.

³⁰ Stein, *op. cit.*, p. 48.

³¹ Gustafson, Thane (1989): *Crisis amid plenty: the politics of Soviet energy under Brezhnev and Gorbachev*, Princeton, Rand Corporation; Oxford, Princeton University Press, pp. 22-35

³² *Ibid.*, *Idem.*

³³ Stein, *op. cit.*, p. 40.

³⁴ Gustafson, Thane (2012): *The wheel of fortune: the battle for oil and power in Russia*, Cambridge, Massachusetts, Belknap Press of Harvard University Press, p. 10.

them in the former area of influence of the Soviet Union, including the three Baltic republics, had an unwelcome effect on Russia, as this brought the expansion of EU's governance standards.³⁵ This heralded several clashes in energy policy as Gazprom would have difficulties in adapting to European regulations.

The general picture of Russia's energy relations with Europe is one of very high dependence on a set of countries which represent the main customers for energy exports.³⁶ There is however a clear imbalance in their importance, both in absolute and relative terms, as for the proportion of Russian gas in the energy mix. This imbalance matches in fact the former division between the Western and the Eastern blocs. Whereas the biggest consumers are located in Western Europe, with Germany, Italy and France,³⁷ volumes sold to Central European countries, as for example Hungary and Poland, are smaller.³⁸ At the same time, whereas Russian gas represents a limited share in the total gas consumption of the Western consumers, some countries like Bulgaria or Slovakia have a 100% dependence.³⁹

This imbalance among European customers has had big consequences for Gazprom's strategy. Gazprom has focused on ensuring good relations with its most important customers, mainly Germany,⁴⁰ while its business policy in Central Europe has been more forceful, with the use of murky and corrupt

³⁵ Stern, Jonathan (2005): *The future of Russian gas and Gazprom*, Oxford, Oxford University Press, p. 109.

³⁶ Closson, Stacy: "Russia's key customers: Europe", in Perovic, Jeronim; Orttung, Robert W and Wenger, Andreas (eds.) (2009): *Russian energy power and foreign relations: implications for conflict and cooperation*, New York, Routledge, pp.89-108; Eurostat data show that in 2012, the Russian Federation's share of the EU-28 imports was 33.7% for crude oil and 32% for natural gas (see:

http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Main_origin_of_primary_energy_imports,_EU-28,_2002%E2%80%932012_of_extra_EU-28_imports%29_YB14.png (Accessed on the 24th April 2015)

³⁷ As Anke Schmidt-Felzmann highlights, half of Gazprom's exports to Europe are consumed by Germany and Italy. This underscores the importance for the Russian monopoly of these two bilateral relations (Schmidt-Felzmann, Anke: "EU member states' energy relations with Russia: conflicting approaches to securing natural gas supplies", *Geopolitics*, vol. 16, no. 3 (2011), p. 579)

³⁸ We must also take into account that Gazprom also supplies large volumes of gas to Turkey. Depending on the inclusion of Turkey in Europe, the proportions of gas sold to these countries obviously change. In fact, with as much as 26bcm of Russian gas consumed in 2012, Turkey is the second biggest consumer after Germany (see: Eurogas (2013): "Statistical Report", table in p. 6, at www.eurogas.org/uploads/media/Eurogas_Statistical_Report_2013.pdf (Accessed on the 23 July 2014). The other big consumer (apart from Russia itself), Ukraine, is usually included in the category of CIS countries.

³⁹ The importance of natural gas for European countries and their degree of dependence on this fuel, has to be qualified considering the share of natural gas in their global energy mix. Thus while in 2012 the share of natural gas in the primary energy consumption for the EU-28 countries was 23.1%, in countries like the Netherlands, this reached around 45%, while in Sweden the percentage was insignificant, close to 0%; for countries highly dependent on Russian gas for their total natural consumption, a big difference can be found for example between Finland and Hungary, both 100% dependent on Russian natural gas, but with natural gas only representing around 5% of the global energy mix in the former, whereas in the latter, this figure reaches around 30% (see: Eurogas, *op. cit.*, pp. 3 and 6).

⁴⁰ As can be seen in Stern, "The future of Russian gas and Gazprom", *op. cit.*, Table 3.1., p. 110, Germany was towering in 2004 with a consumption of 40.87bcm of Russian gas, compared to its consumption rate in 1990 of only 26.6bcm and compared to Italy and France, with 21.55bcm and 14.02bcm respectively. With data for the year 2012, Germany consumed 31.3bcm, Italy 21bcm and France 7,2bcm (see: Eurogas, *op. cit.*, p. 6.).

schemes been also quite common.⁴¹ This has also had consequences on its pricing policy: large Western consumers have always been able to hold an advantage in negotiations as opposed to smaller and more dependent consumers. Finally, it has also affected perceptions of Russian energy policy whenever energy disputes have affected supply; besides being more vulnerable, Central European countries had a very negative perception of Russia as heir of the former Soviet Union, especially since Putin took a more assertive turn, which many commentators have equated to a second cold war.

The existing dichotomies between Western and Central Europe which have been mentioned in the paragraph above, have also gained in complexity with the increasing importance of the European Union as a determinant actor by way of its legislation on energy.⁴² Before the EU's energy legislation came to affect Gazprom's strategy and the general Russian conception of energy policy, the first clash in philosophies was exemplified already by the Russian Federation's refusal to the Energy Charter Treaty's (ECT) principles. While having signed the charter in the 90s, it never proceeded with its ratification, while the charter's transit protocol, though tentatively agreed, has not come into force.⁴³ As the final result of this clash of philosophies, Russia withdrew from the ECT in July 2009.⁴⁴ This decision, which was the logical result of the state of affairs since many years before, came in the wake of the new energy concept espoused by President Dmitri Medvedev in April 2009.⁴⁵ This concept reaffirmed the main misgivings Russia had always maintained against the ECT, namely its being biased in favor of consumer countries, who would benefit from an open market while Russia would see control on its energy resources weakened.⁴⁶

⁴¹ In this respect, we can read Roman Kupchinsky's explanation (see: Kupchinsky, Roman (2009): *Gazprom's European web*, Jamestown Foundation, Washington DC.) of the murky commercial relations that Gazprom maintains in Europe through obscure and not clearly legal companies. For a description of Russia's energy policy in Eastern Europe since the fall of the Soviet Union and the complex web of alliances with different Eastern European governments and the internal factors in these which either facilitated or made more difficult cooperation with Russian companies, see: Orban, Anita (2008): *Power, energy, and the new Russian imperialism*, Westport, Conn.: Praeger Security International. For a very negative reading of the use of energy in the European Union in general and Eastern Europe in particular, see: Bugajski, Janusz (2009): *Dismantling the West: Russia's Atlantic agenda*, Washington, D.C.: Potomac Books.

⁴² Due to the overbearing presence of the EU bloc, Russia has responded by resisting European attempts at exporting its energy model, thus rejecting signature of the Energy Charter, consolidating its national champions both at home and abroad, and complementing this staunch support of a statist energy business model with diplomatic calls to ease its dependence on Europe as its main customer (Haukkala, Hiski: "Lost in translation? Why the EU has failed to influence Russia's development", *Asia-Europe Studies*, vol. 61, no. 10 (2009), pp. 1761).

⁴³ For an introduction to the Energy Charter Treaty process, its relation to the Russian Federation's energy policy, see: Belyi', Andrei': "The EU's missed role in international transit governance", *Journal of European Integration*, vol. 34, no. 3 (2011), pp. 4-.

⁴⁴ Van Agt, Christof: "Tabula Russia: escape from the Energy Charter Treaty", *CIEP Briefing Paper* (September 2009), p. 2, at http://clingendael.info/publications/2009/20091001_ciep_paper_cvanagt_russia.pdf.

⁴⁵ *Ibid.*, pp. 10-14.

⁴⁶ Russia fears that if the principles of the ECT were applied in Russia, it could no longer discriminatingly support some actors, namely state or quasi-state companies. Interventions such as that which dismantled Yukos, attempts to influence the TNK-BP

However, the main reason for Russia's refusal derives from its intention to maintain its transport monopoly of Central Asian energy exports. Thus, Russia rejects the ECT for its provisions on the right of first access to pipelines and transit tariffs,⁴⁷ even if too often, its interpretations do not correspond with the exact content of the ECT.⁴⁸ The EU's intention to exempt energy transit within the European Community to comply with the ECT transit provisions has constituted the main stumbling block to reaching an agreement with Russia.⁴⁹ If Pr. Konoplianiuk favored the ECT as the best framework for a common governance between Russia as a supplier and its European consumers,⁵⁰ the reality is that this will hardly be possible due to resistance from Russia.⁵¹ Thus, mostly determining for Russia are the bilateral relations it may establish with consumer states and with the European Union, which are briefly reviewed below.

Russian Energy Relations with Western and Central Europe

As seen above, Europe is mostly split into two blocs: from one side, Western Europe contains countries, which like Germany and Italy, are its main consumers in absolute terms,⁵² but which are fairly diversified and have a relatively low dependence on Russian gas. From the other side, we find the inverse picture in Central Europe, where there is no such big consumers as on the Western side of the former East-West divide, but where Gazprom's consumers have in general a much higher rate of dependence.⁵³

From the end of the Soviet Union, Russia saw a fruitful cooperation with Germany bloom. Gazprom managed to penetrate the German downstream market, where to date, many of the benefits of

partnership or the modification of exploitation contracts of foreign companies in Sakhalin could not be possible under the ECT provisions. The interest of the Russian state in maintaining the status quo at the present time can be understood as the need to maintain the control of flows of exports based on political considerations, being thus able to maintain subsidized internal gas prices and to finance the state budget through its greater presence in the energy sector (see: Handke, Susann and de Jong, Jacques J.: "Energy as a bond: relations with Russia in the European and Dutch context", *Clingendael Energy Paper* (September 2007), pp. 55-, at

http://www.clingendaelenergy.com/inc/upload/files/Energy_as_a_bond.pdf, for a correction of many of Russia's assumptions).

⁴⁷ Handke and de Jong, "Energy as a bond", *op. cit.*, p. 52.

⁴⁸ From among the four main contentious issues, nuclear trade, the EU extension to cover most of the ECT members, investments and transit, the authors (Handke and de Jong) of "Energy as a bond", *op. cit.*, recognize the strongest arguments concern the latest (*Ibid.*, p. 54).

⁴⁹ Belyi, "The EU's missed role", *op. cit.*, p. 6.

⁵⁰ Konoplianiuk, Andrei: "A common Russia-EU energy space: the new EU-Russia partnership agreement, *acquis communautaire* and the Energy Charter", *Journal of Energy & Natural Resources Law*, vol. 27, no. 2 (May 2009), p. 251.

⁵¹ The author highlights both Russia's reservations which are unjustified, and which derive either from misunderstandings or from political reasons (to trade any eventual agreement in exchange for agreements in other unrelated areas) and those which, on the contrary, are justified, mostly related to transit issues and which could be resolved if the EU became more flexible (see: *Ibid.*).

⁵² Excepting again Turkey.

⁵³ See: Noël, Pierre: "EU gas supply security: unfinished business", Cambridge Working Papers in Economics, *EPRG Working Paper*, no. 1308 (April 2013), pp. 2-3, at <http://www.econ.cam.ac.uk/dae/repec/cam/pdf/CWPE1312.pdf>.

direct sales to consumers were out of reach.⁵⁴ As Andreas Heinrich and Heiko Pleines explain, relations developed slowly but in the clear direction of cooperation.⁵⁵ Starting with cooperation with Ruhrgas (which merged with E.ON in 2003), dating back to the 70s, from October 1990, cooperation was expanded to another company, Wintershall,⁵⁶ with whom Gazprom created the Joint Venture Wingas in 1993, where it reached 50% ownership in 2007.⁵⁷ Cooperation with Ruhrgas continued too and even deepened with the German company becoming a share-holder of Gazprom from 1998 to 2009-2010.⁵⁸ The synergies existing between Russia and Germany in the energy sector are probably best exemplified in the construction of Nord Stream (see chapter 9) in partnership with both E.ON-Ruhrgas and Wintershall (besides Gasunie and Gaz de France), in service from 2011 and which represents the first direct link between Russia and Germany, bypassing any transit countries.⁵⁹ The next partner in importance is undoubtedly Italy, not only through being the second consumer of its gas in Europe, but also for the patterns of cooperation that have developed between each other. Thus the Italian ENI has been a key partner in the construction of the pipeline Blue Stream from Russia to Turkey, officially inaugurated in 2005, and is also a partner in the important and controversial project of South Stream, another pipeline that was to cross the Black Sea bypassing Ukraine and which was cancelled in December 2014.

It must be said that these patterns of cooperation either just overlap or feed back into patterns of geopolitical positioning of the Russian Federation. The same way Germany is a priced energy partner, it

⁵⁴ Stern, "The Future of Russian Gas and Gazprom", *op. cit.*, p. 111.

⁵⁵ Heinrich, Andreas and Pleines, Heiko: "Strategiia sotrudnichestva nemetskikh gazovykh kompanii s gazpromom", in s.a.u. (2013): *Rossii i Germaniia v Prostranstve Evropeiskikh Kommunikatsii*, Tiumen, Russia, FGBU VPO Tiumenskii gosudaerstvennyi Universitet, p. 197.

⁵⁶ As Jonathan Stern explains, Gazprom (at the time still the Ministry of Gas Industry) was harshly rebuked in 1989 when trying to expand cooperation to reach the downstream sector (see: Stern, "The Future of Russian Gas and Gazprom", *op. cit.*, p. 111). However, Gazprom found a ready partner in Wintershall, the gas company founded by the chemical giant BASF, and which was precisely interested in bypassing the monopoly of Ruhrgas and obtaining better conditions. In exchange for this, Gazprom could obtain access to the downstream sector as it had been seeking (see: Victor, David & Victor, Nadejda Makarova: "The Belarus connection: exporting Russian gas to Germany and Poland", *Geopolitics of gas working paper series*, Baker Center, Stanford (August 2004), p. 22, at http://iis-db.stanford.edu/pubs/20603/Yamal_final.pdf (Accessed on the 25th February 2014).

⁵⁷ Heinrich and Pleines, *op. cit.*, p. 199. Cooperation between the two companies expanded into other sectors too, such as downstream production in the Russian territory with the constitution of a new joint venture called "Akhimgas" (see: *Ibid.*, p. 200).

⁵⁸ *Ibid.*, p. 200. As in the case of Wintershall, E.ON Ruhrgas also cooperated with Gazprom in the sector of upstream production in Russia (see: *Ibid.*, *Idem*). The cooperation with these two German companies was the beginning for Gazprom's penetration into the downstream market of Europe, with the constitution of several joint ventures and the acquisition of shares in other companies (see the list by 2005 in: Stern, "The future of Russian gas and Gazprom", *op. cit.*, Table 2.3., p. 113).

⁵⁹ There has been an extensive discussion regarding the economic benefits thereof, with some authors stating the economic rationale for its construction, while others on the opposite highlight the underlying political reasons, namely to free Russia from the influence of transit countries. The following authors defend its economic rationale: Chi Kong Chyong, Pierre Noël and David M. Reiner: "The economics of the Nord Stream pipeline system", *EPRG Working Paper* 1026 (September 2010), at <https://www.repository.cam.ac.uk/bitstream/handle/1810/242076/cwpe1051.pdf?sequence=1>; Raabe, Stephan: "Der Streit um die Ostsee-Gaspipeline: Bedrohung oder notwendiges Versorgungsprojekt?", *Rapport der Konrad-Adenauer-Stiftung*, no. 14 (2009), at http://www.kas.de/wf/doc/kas_18262-1522-1-30.pdf?091130150756.

is an equally important political partner since the Soviet Union disappeared and the Russian Federation had to face the reality of its much diminished role in Europe.⁶⁰ Relations with Germany easily fit into what Hanna Smith highlights as the Russian preference for bilateral relations when multilateralism does not work,⁶¹ or in what Derek Averre refers as "selective partnership".⁶² In fact, these relations fit into the pattern of bilateralization of Russia's relations, not only with Western Europe, but also with Central European countries too. Tuomas Forsberg and Antti Seppo have shown how several trade disputes were solved at the bilateral level while the involvement of the European Commission had no effect.⁶³ The European Union, which following Hiski Haukkala term's, is seen by Russia as a "normative hegemony",⁶⁴ also incorporates visions of countries hostile to Russia (mainly Poland) and freezes the negotiating agenda in the "lowest common denominator".⁶⁵

In the case of Central Europe, the picture has been revealed to be quite different because of the pattern of energy dependence and the historical legacy already mentioned above. Unlike what happened with Western countries, in these countries, diversification has been pursued away from Gazprom, with maybe the most notable example being the agreement of Czech Transgas with the Norwegian GFU for gas deliveries in 1997.⁶⁶ However, the stance taken by the Czech Republic rather seems to be an

⁶⁰ Stent, Angela (1999): *Russia and Germany reborn: unification, the Soviet collapse, and the new Europe*, Princeton, Princeton University Press.

⁶¹ Smith, Hanna: "Russia's policy towards the European Union: Introduction" in Smith, Hanna (ed.) (2006): *The two-level game: Russia's relations with Great Britain, Finland and the European Union*, Helsinki, Aleksanteri Institute, p. 11. Russia has always promoted a vision of foreign policy based on a multipolar world arranged multilaterally (see: Smith, Hanna: "What can multipolarity and multilateralism tell us about Russian foreign policy interest?" in Smith, Hanna (ed.) (2005): *Russia and its foreign policy: influences, interests, issues*, Helsinki, Kikimora Publications, p. 35-50) but as for relations with European states, Russia has recourse mainly to bilateral relations (see: Smith, "Russia's Policy towards the European Union", *op. cit.*, pp. 7-25).

⁶² Averre, Derek: "Russia-EU security cooperation", in Smith, "The two-level game", *op. cit.*, p. 131. The Russian Minister of Foreign Affairs, Sergei Lavrov seems to have summed it up perfectly when he stated that "the leading European states have become a kind of locomotive in promoting our partnership with Europe: on national interests pursued cooperatively" (see: *Ibid.*, p. 128).

⁶³ Forsberg, Tuomas and Seppo, Antti: "Power without influence? The EU and trade disputes with Russia", *Europe-Asia Studies*, vol. 61, no. 10 (December 2009), pp. 1805-1823; The failure on the part of the European institutions to influence Russia is part of its resistance to normative power, be it in the case of human-right promotion (see: Saari, Sinikukka: "Russia's creeping challenge to European norms: European promotion of abolition of the death penalty in Russia", in Hopf, Ted (2008): *Russia's European choice*, New York, Palgrave Macmillan, pp. 97-121), or more specifically regarding EU's attempts to influence Russia's political development (Haukkala, "Lost in translation?", *op. cit.*)

⁶⁴ Haukkala, Hiski: "The European Union as a regional normative hegemon: the case of European Neighbourhood Policy", *Europe-Asia Studies*, vol. 60, no 9 (Dec. 2008), pp. 1601-1622.; this explains why Russia has since its inception rejected the normative basis of the European Neighborhood Policy (ENP) and has preferred relations of equality instead, where each other's sovereignty is preserved.

⁶⁵ Averre, Derek: "'Sovereign democracy' and Russia's relations with the European Union", *Demokratizatsiya*, vol. 15, no. 2 (2007), p. 175.

⁶⁶ Stern, "The future of Russian gas and Gazprom", *op. cit.*, p. 115.

exception in the general picture, with many countries not only being unable to get rid of Gazprom as the main supplier but actually increasing its cooperation.⁶⁷

If general interests seem to have been the main guide in relations with Germany and Italy, in the case of many countries in Central Europe, more opaque political interests have been the main support for Gazprom's penetration. Pro-Gazprom policies have tended to swing back and forth depending on government changes in many of these countries, but in general, while the penetration of obscure business schemes secured an important buffer against deals being revisited, more importantly the geographical situation plays to Russia's advantage, as access to alternative suppliers is difficult. With Netherlands, Norway and Denmark out for reach excepted for some marginal supplies,⁶⁸ Russia remains the main supplier. The opportunities offered by LNG may not be competitive in the face of the costs involved.⁶⁹

Russian Energy Policy towards the European Union

The increase in influence by the European Union towards the Russian Federation and its giant Gazprom has been incremental both in the sense that the European Union has increased its geographical scope and its legislative drive in the energy sector. As professor Konoplianiuk has highlighted, whereas the current Partnership and Cooperation Agreement (PCA) of 1994 did not include any part referring to energy,⁷⁰ both the four Common Spaces agreed in 2003 and the Road Map for their implementation from 2005 introduced energy into their common interests; conversations in 2008 for the renewal of the PCA strongly focused on this matter.⁷¹ The problem regarding the EU-Russia dialogue is that of utter asymmetry provoked by the EU's policy of convergence towards its *acquis communautaire* instead of the philosophy

⁶⁷ From among the cooperative countries within the European Union, Hungary and Bulgaria, vital partners in the construction of the pipeline South Stream are the most important. Without the EU, Serbia is also a close partner of Gazprom and was also a partner in South Stream. On the opposite side, we can find Poland along with Lithuania, trying to reduce dependence on Russia while at the same time promoting energy policies that target Gazprom at the EU level; most relevant among recent policy initiatives, is the Polish proposal to create an energy union at the EU level, which would negotiate prices with Gazprom.

⁶⁸ Except for the Czech Republic, Hungary has been importing some marginal volumes of gas from Germany (Stern, "The future of Russian gas and Gazprom", *op. cit.*, p. 111) and Poland has managed to have some access to Norwegian gas (*Ibid.*, p. 116) and for some years, gas from Central Asian imported through EuralTransGas and RosUkrEnergo. In the case of the latter, better located geographically than other landlocked countries, Russia has managed to play its hand successfully with its diversification efforts through Belarus in avoidance of Ukraine with the construction of the Yamal pipeline (see: Victor and Victor, *op. cit.*) that runs through Poland; for Poland this has highlighted the advantage involved in Russian gas (see: Stern, "The future of Russian gas and Gazprom", *op. cit.*, p. 116).

⁶⁹ This has nevertheless not stopped Poland, Lithuania and Estonia to build LNG terminals. When finished, these will offer cheaper gas than Gazprom's, given the fact that spot prices are currently below the latter's. However, the long-term forecasts do not favor this trend, so LNG gas should become more expensive.

⁷⁰ Energy is mentioned (art. 65) indeed but it is only a particular aspect within the dimension of the economic cooperation between the EU and Russia, not a section by itself (see: Handfield, Amelia: "EU-Russia energy relations: aggregation and aggravation", *Journal of Contemporary European Studies*, vol. 16, no. 2 (2008), pp. 231-248.

⁷¹ Konoplianiuk, "A Common Russia-EU Energy Space", *op. cit.*, pp. 258-291.

favoured by Russia of reciprocity.⁷² This reproduces the general pattern of EU-Russia relations, where the former only understands harmonizing cooperation not as convergence, but as the adoption by Russia of the EU standards.⁷³ We may follow Caroline Kuzemko when stating that the EU has adopted the liberal model in the wake of the end of the Cold War out of the conviction that it is intrinsically superior.⁷⁴ The philosophy of the EU in the so-called third energy package,⁷⁵ which deepens the liberalizing agenda and its promotion of new energy outlets bypassing Russia like the pipeline "Nabucco" are two examples of the EU's policy as opposed to the Russian agenda. From the Russian side the discourse is rather focused on deepening cooperation with EU countries in avoidance of troublesome transit countries like Ukraine (Nord Stream and South Stream pipelines) and as already mentioned, reciprocity in their mutual relations. Unfortunately, the gulf remains at this stage unbridgeable.

The beginning of the past decade started with positive signs though. The Russian Federation, which managed to maintain and even increase its energy resources production in oil and gas, and which nevertheless saw in its own economic collapse a way to free more resources for export (See chapter 3), appeared as a very suitable option for Europe at the onset of the 00s decade. The importance of increasing gas in the energy share of the EU, due to the cleanliness of natural gas as compared to coal, and the fact that the Russian Federation appeared as a reliable supplier, set the stage for a deepening of the already existing relation of interdependence. Thus came the Joint Declaration of the October 2000 EU–Russian Summit, where a Russia-EU energy dialogue was established,⁷⁶ with the support of the Vice-President of the European Commission, Loyola de Palacio, in charge of energy. This promising start seemed to be confirmed with the inclusion of energy as part of the common economic space, when the EU-Russia Common Spaces were agreed in May 2003, as it had not been part of the EU-Russia Partnership and Cooperation Agreement, in force since 1997, and renewed each year since 2007. During this time Russian natural gas exports to Europe increased, even if it grew more slowly than other suppliers and in relative terms, the share of Gazprom's gas fell in percentage from 75% in 1990 to 40% in 2008,⁷⁷ whereas in 2013 it fell further to 30%. In spite of the eventual worsening of these beginnings, an important legacy from

⁷² *Ibid.*, p. 268. As Konoplianiuk explains, reciprocity is understood by Russia in this context as exchange in quantitative parameters, as for example assets.

⁷³ Pursiainen, Christer: "Theories of integration and the limits of EU-Russian relations", in Hopf, *op. cit.*, pp. 159-161.

⁷⁴ Kuzemko, Caroline: "Ideas, power and change: explaining EU–Russia energy relations", *Journal of European Public Policy*, vol. 21, no. 1 (2014), p. 58.

⁷⁵ The two previous ones date from 1998 and 2003.

⁷⁶ See: Johnson, Debra: "EU–Russian energy links: a marriage of convenience?", *Government and Opposition*, vol. 40, no. 2 (2005), p. 272.

⁷⁷ Noël, Pierre: "The EU and Russia's gas", *European Council on Foreign Affairs* (21 Nov. 2008), at http://www.ecfr.eu/content/entry/commentary_the_eu_and_russias_gas/.

this period, of utmost importance for subsequent developments (see chapter 9), was the inclusion of the future Nord Stream as a EU strategic project.

However, contradictions and differences soon started to surface between the EU and Russia, as it appeared that indeed, the fifth element of the energy dialogue, the creation of a pan-European energy market, implied the adoption by the Russian Federation of the EU's standards and norms.⁷⁸ During this period in fact, the adoption of the second gas directive in 2003 deepened the EU's drive towards an integrated and liberalized market,⁷⁹ making Russia's integration into the European normative space even more difficult. The EU's stance and the increasing divergence this brought in relation to Russia's interests were exemplified in the former's intention to integrate the Energy Dialogue into discussions regarding the Common Economic Space,⁸⁰ thus subsuming it into an economically liberal logic which the Russian Federation rejected. The EU's pretensions to modify the Transit Protocol (TP) of the ECT, agreed in 2003, in order to introduce the EU as a Regional Economic Integration Organization (REIO), instead of each individual EU member;⁸¹ the EU's introduction in the WTO dialogue for Russia's membership of the so called "Lamy package", where the EU tried to impose on Russia internal transit tariffs for domestic consumers equal to transport tariffs,⁸² with the aim of making Russia's energy market market-friendly by the back-door; and the refusal by the European side to apply reciprocity in asset swaps, with Gazprom being refused assets in the European down-stream sector, and with Russia barring entry of Western capital in its upstream investments as a retaliation,⁸³ worsened common energy relations.

Energy relations between Russia and the EU further deteriorated as a result of both the energy disputes which will be analyzed later, the (closely related) promotion of the Nabucco pipeline as an alternative to Russian gas (see chapter 10) and the reform of the EU's energy market into the direction of further liberalization. This process of reform led to the so-called third energy package. The problem for Russia is that in spite of not adapting its legislation in the direction of the European energy policy, it unavoidably affects it as the EU is its main energy partner. The disadvantages that the liberalization have brought to Russia are best exemplified in the so-called contract discrepancy, with Gazprom insisting on

⁷⁸ Romanova, Tatiana: "The Russian perspective on the energy dialogue", *Journal of Contemporary European Studies*, vol. 16, no. 2 (2008), p. 220; on the contending philosophies of legal harmonization or legal approximation, see: Romanova, Tatiana: "Legal approximation in energy: a new approach for the European Union and Russia", in Kuzemko, Caroline; Belyi, Andrei V.; Goldthau, Andreas and Keating, Michael F. (2012): *Dynamics of energy governance in Europe and Russia*, Basingstoke; England, Palgrave-Macmillan, pp. 23-44.

⁷⁹ See: Yafimava, Katja (2011): *The transit dimension of EU security*, Oxford, Oxford University Press., pp. 116-128.

⁸⁰ Romanova, "The Russian perspective", *op. cit.*, p. 222-223.

⁸¹ *Ibid.*

⁸² Konoplianik, "Gas transit in Eurasia", *op. cit.*, p. 472.

⁸³ Romanova, "The Russian perspective", *op. cit.*, p. 224.

the sanctity of contracts in the face of the new legislation.⁸⁴ Supply contracts that are signed under the new legislation must adapt to new conditions such as the end of the destination clause, but Gazprom obviously opposes that this should apply to previous contracts that were extended in 2006.⁸⁵ The disappearance of the destination clause can become a determinant element in Russia-Ukraine energy relations, as henceforth, Russian gas sold to countries like Poland, Hungary and Slovakia can be resold in reverse mode to Ukraine.⁸⁶ Equally disturbing for Gazprom is the separation between supply and transfer which is mandatory since the 2009 gas directive (the so called third directive, which became law in March 2011). The EU legislation foresees three ways to unbundle: ownership unbundle, independent system operator (ISO) or independent transmission operator (ITO).⁸⁷ Although the legislation also foresees exemptions for projects of strategic interest,⁸⁸ the European Commission did not grant an exemption for South Stream (see chapter 10), standing in the way of Gazprom's strategy to bypass Ukraine. With the current EU legislation guaranteeing third party access in accordance with the third energy package, operators have to guarantee third party access;⁸⁹ this was precisely one of the main reasons for the Commission's reluctance to grant such exemption. In fact, Gazprom has already seen the exact impact of this policy on other projects already terminated. This is the case with the OPAL pipeline, a small pipeline that connects Nord Stream (see chapter 10) with other pipelines like "JAGAL" and "STEGAL".⁹⁰ The initial intention by the European Commission was to prohibit Gazprom to occupy more than 50% of the pipeline's capacity, even if the final decision has not yet been taken at the time of writing. The opposition between the European Commission and Gazprom found a good example in the investigation that was launched against the Russian company for anti-competitive practices.⁹¹

⁸⁴ Konoplianiuk, Andrei: "Reducing risks and uncertainty of the EU third package", *Energy Dialogue* (2012), at http://www.konoplianiuk.ru/ru/publications/articles/511_Reducing_risks_and_uncertainty_of_EU_Third_Energy_Package.pdf. As professor Konoplianiuk explains, targeting long-term contracts by EU national champions, Gazprom has become a "collateral" damage as the gas directive also affects the Russian company; for a discussion on other negative aspects for Gazprom, see: Yafimava, Katja: "The EU third package for gas and the gas target model: major contentious issues inside and outside the EU", The Oxford Institute for Energy Studies (April 2013), at <http://www.oxfordenergy.org/wpcms/wp-content/uploads/2013/04/NG-75.pdf> (Accessed on the 21st May 2014), pp. 29-51.

⁸⁵ Yafimava, "The transit dimension of EU energy security", *op. cit.*

⁸⁶ The paradox stems from the fact that as a result of the January 2009 contract (see chapter 8), Gazprom's gas is more expensively priced in Ukraine than for other clients further West, even after taking into account transportation costs.

⁸⁷ Yafimava, "The EU third package for gas and the gas target model", *op. cit.*, p. 3, ft. 4.

⁸⁸ See: Yafimava, "The transit dimension of EU energy security", *op. cit.*

⁸⁹ "Austria seals South Stream deal with Gazprom", *Euractiv*, 26 June 2014, at <http://www.euractiv.com/sections/energy/austria-seals-south-stream-deal-gazprom-303046> (Accessed on the 23rd July 2014).

⁹⁰ The "Jamal-Gas-Anbindungsleitung" is the German section of the Yamal Pipeline, while the "Sachsen-Thüringen-Erdgas-Anbindungsleitung" connects the Czech Transgas pipeline with JAGAL.

⁹¹ Konoplianiuk, Andrei: "The EU versus Gazprom", *Energy Economist*, no. 372 (October 2012), at http://www.konoplianiuk.ru/ru/publications/articles/509_The_EU_versus_Gazprom.pdf (Accessed on the 14th March 2014).

Finally, the latest negative element in Russia's energy relations is the EU's promotion of hub-based market pricing for gas,⁹² as opposed to the long-term gas export contract (LTGEC) favored by Gazprom and based on the Groningen model.⁹³ Two realities, one economic and one legal have negatively impacted on Russia's energy export policy. From the economic side, US shale gas revolution has had a double impact: from one side, the outstanding conversion of the US from its peak of LNG gas imports in 2007 to the status of self-sufficient gas producer, left a surplus of LNG gas in the global market, initially planned for the US. This pushed gas prices downwards. Probably the main trigger to translate this reality in Europe was the decision of Norway to adapt its gas prices to this new reality, to abandon oil-indexation for gas-to-gas competition (indexed to gas spot prices instead)⁹⁴, in benefit of Europe's consumers and obviously in Gazprom's prejudice;⁹⁵ as the 10-year agreement between Statoil and Wintershall in 2012 foresaw, Norwegian gas would be traded at spot prices.⁹⁶ However, the influence of the EU in this change should not be underestimated, as the enforcement by national regulators of pipeline access, following the EU's legal reforms, was determinant for the creation of a LNG market in Europe.⁹⁷ From the legal side, a set of decisions by the International Arbitration Court forced Gazprom to translate, at least partially, this new market trend. The Court ruled in favor of the German energy company RWE against Gazprom, accusing the latter of overpricing its gas in relation to spot prices,⁹⁸ while a year before, in a similar ruling, RWE Transgas, the main Czech gas importer, won the right not to pay for non delivered gas,⁹⁹ nullifying thus the "take-or-pay clause".¹⁰⁰ As a consequence, Gazprom has

⁹² The European LNG-based natural gas hub market evolved first in the UK and then translated into other European countries (see: Heather, Patrick: "The evolution and functioning of the traded gas market in Britain", The Oxford Institute for Energy Studies, NG 44 (August 2010) at

[http://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG44-](http://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG44-TheEvolutionandFunctioningOfTheTradedGasMarketInBritain-PatrickHeather-2010.pdf)

[TheEvolutionandFunctioningOfTheTradedGasMarketInBritain-PatrickHeather-2010.pdf](http://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/NG44-TheEvolutionandFunctioningOfTheTradedGasMarketInBritain-PatrickHeather-2010.pdf)); Heather, Patrick: "Continental European gas hubs: are they fit for purpose?", The Oxford Institute for Energy Studies, NG 63 (June 2012), at

<http://www.oxfordenergy.org/wpcms/wp-content/uploads/2012/06/NG-63.pdf> (Accessed on the 2nd April 2014); Interestingly, as Noël states, the Russian leadership has precisely seen the transition away from oil-indexed pricing in Europe as an explicitly anti-Russian move (see: Noël, *op. cit.*).

⁹³ For an explanation thereof, see: Konoplianiuk, Andrei: "Gas transit in Eurasia: transit issues between Russia and the European Union and the Role of the Energy Charter", *Journal of Energy and Natural Resources Law*, vol. 27, no. 3 (August, 2009), pp. 447-449.

⁹⁴ For an explanation of the pricing formulae for natural gas, see: Varró, Laszló; ten Kate, Warner and Corbeau, Anne-Sophie: "Developing a natural gas trading hub in Asia: obstacles and opportunities", IEA (2013), at http://www.iea.org/media/freepublications/AsianGasHub_WEB.pdf (Accessed on the 21st May 2013).

⁹⁵ See: Gotev, Georgi: "Norway overtakes Russia as EU's biggest gas supplier", *Euractiv*, 25 June 2013, at <http://www.euractiv.com/energy/norway-overtakes-russia-biggest-news-528854> (Accessed on the 2nd April 2014).

⁹⁶ See: Puka, Lidia: "New government, same track: Norway and its European and energy policies", Polish Institute of Foreign Affairs, *Bulletin*, no. 113 (24 October 2013), at https://www.pism.pl/files/?id_plik=15099 (Accessed on the 2nd April 2014).

⁹⁷ Noël, *op. cit.*, p. 6.

⁹⁸ "No more 'take-or-pay': Gazprom forced to end 40 year-old gas pricing regime", *Russia Today*, 10 July 2013, at <http://rt.com/business/gazprom-rwe-germany-gas-893/> (Accessed on the 21st May 2014).

⁹⁹ "Czech company wins case against Gazprom over 'take or pay'", *Russia Today*, 25 October 2012, at <http://rt.com/business/czech-rwe-gazprom-dispute-212/> (Accessed on the 21st May 2014).

increasingly accepted the renegotiation of contracts in order to reflect natural gas prices in the spot market.

Even worse, as an effect of the pressure the European Commission exerted on Gazprom in 2012-2013, the Russian company had to waive the destination clauses that protected its supplies from further reselling to third parties.¹⁰¹ As seen above, destination clauses were officially suppressed in the third gas directive of 2009.¹⁰² The negative effect made its appearance in 2013 when the German RWE started exporting Gazprom's natural gas sold in Poland and Hungary to Ukraine: owing to price differences, Ukraine ended up buying 2.2bcm of gas at prices slightly cheaper than natural gas sold directly from Russia. As a result of the 17 December agreements, where Gazprom offered the Ukrainian Naftohaz a 33% reduction in gas prices,¹⁰³ these imports ceased being favorable. However, the changing political landscape in Ukraine, with the ousting of President Viktor Yanukovich, brought the cancellation of this political price reduction from April 2014. Since then, plans to renew imports from Poland and Hungary, and to start importing gas from Slovakia, have resurfaced.¹⁰⁴

¹⁰⁰ According to this type of clauses, the supplier is bound to deliver a minimum volume, whereas the consumer commits to paying a minimum volume, even if it ends not needing as much gas for its consumption. Gazprom usually set in its contracts that the consumer had the right to freely consume as little as 80% of the annual gas volumes agreed in the contract.

¹⁰¹ Konoplianiuk, "Gas transit in Eurasia", *op. cit.*, pp. 453-454.

¹⁰² Yafimava, "The transit dimension of EU energy security", *op. cit.*

¹⁰³ See: Balmaceda, Margarita: "Will cheap Russian gas save Ukraine?", *Problems of Post-Communism*, vol. 61, no. 1 (March-April 2014), pp. 61-67.

¹⁰⁴ This option does not offer problems from the technical point of view ("Evropa ne zametit do noiabriia. Gazprom mozhет ostavit' Ukrainu bez gaza do noiabriia (Европа не заметит до ноября». «Газпром» может оставить Украину без газа на лето)", *Dozhd*, 5 April 2014, at

http://tvrain.ru/articles/evropa_ne_zametit_do_nojabrja_gazprom_mozhet_ostavit_ukrainu_bez_gaza_na_letu-366413/

(Accessed on the 21st May).), but it does from the legal point of view, as most of the capacity of the pipeline owned by the Slovak "Eustream" (around 90%), is contracted by Gazprom (see: Seninskii', Sergei': "Uzli slovatskogo reversa (Узлы словацкого реверса)", *Radio Svoboda*, 21 March 2014, at

<http://www.svoboda.org/content/article/25366802.html> (Accessed on the 21st May 2014).

PART III: ENERGY DISPUTES AND THE STATUS QUO

As was explained in our first chapter, the question of why Russia escalated or deescalated the three energy disputes that are the object of study in this research, would be answered by the analysis of two independent factors: changes in the status quo and changes in the risk factor, mostly based on the development of diversification projects during the period analysed of 2005 to 2008/9.

This third part of this Phd thesis will be devoted to the first independent variable. From the following chapters 6 to 8, an analysis of the energy disputes of January 2006, March 2008 and January 2009 will be carried out. However, most of the chapters will be devoted to the evolution of circumstances that would eventually lead to each of these disputes, spanning thus the whole period encompassing the years 2005 to 2008, including the first weeks of 2009, where the third energy dispute evolved. After the background to this period was explained in Part II, with chapter 4 devoted to Russia-Ukraine energy relations, we have decided to establish the starting point of this part in 2005, right after the Orange Revolution. This political event led to Yushchenko's administration in Ukraine and to the alternation during the period 2005-2010 of governments of different sign, including "orange" governments led by Prime Minister Yulia Tymoshenko and an interregnum by Viktor Yanukovich from October 2006 to December 2007.

The political element of this period is thus crucial to establish the period, in particular, because the three energy disputes happen then. However, the three following chapters will not be a political chronic. The political element looms in the background and will be mentioned whenever necessary. Chapters 6 to 8 will be mostly an explanation of the evolution of energy relations between Russia and Ukraine, as well as an explanation of larger energy factors, such as changes in pricing policies in Central Asia, mainly Turkmenistan (the other big supplier in natural gas for Ukraine apart from Russia) and the international context of increasing energy prices. Due to the richness in factors constituting Russo-Ukraine energy relations and the complex and sometimes misleading negotiations to introduce changes, triangle Russia-Ukraine-Turkmenistan will occupy a good deal of all the space devoted to the evolution leading to the disputes. This may result confusing at some points for the reader, as we have decided to reflect, through press releases and analyses, each of the elements in discussion, including *fausse routes* and either conscious or unconscious informative intoxication. The goal is informative, so as the reader may have a clear picture of the complexity and the room this leaves to negotiations. This is especially so in the numerous episodes of indebtedness from the part of Ukraine.

In addition to the complexity pointed out above, the reader will have to cope with much confusion as for several sub-state agents that have a radical importance. The two most relevant actors are obviously, Gazprom and Naftohaz, the natural gas monopolies from Russia and Ukraine. As we already discussed in chapter 1, we may assume that Gazprom's interests were aligned with those of the central state. As for Naftohaz, we will have the occasion to see in the next three chapters, the company was heavily politicized, with its leadership changing according to political changes. However, the picture becomes more complex with the appearance of energy traders, as explained in chapter 4. During our period, two energy traders will play a very important role: RosUkrEnergo and UkrGazEnergo. RosUkrEnergo appeared already in chapter 4, closing in fact the series started by its predecessors Respublika, Itera and EuralTransGas. As we will have the occasion to see in chapter 6, as a result of the agreement reached to put an end to the dispute, RosUkrEnergo's role is expanded. RosUkrEnergo, as explained in chapter 4, is in itself owned 50% by two companies: Arosgas, whose indirect owner was Gazprom's filial Gazprombank (in late 2006 Gazprom became direct owner) and Centragas, owned by two Ukrainian businessmen: Dmitro Firtash (90% of Centragas) and Ivan Fursin (10% of Centragas).

The expanded role of RosUkrEnergo will henceforth establish a complex chain in energy relations: Gazexport, Gazprom's external filial, purchases Central Asian gas at these countries' respective border (Turkmenistan, but also Uzbekistan and Kazakhstan), reselling part thereof (if not all) to RosUkrEnergo, who carries volumes of natural gas to the Russo-Ukrainian border. Naftohaz, thereafter, purchases part of RosUkrEnergo's natural gas meant for consumption in Ukraine. Then the twisted scheme becomes even more complex with the appearance of a new actor: UkrGazEnergo. UkrGazEnergo, functioning from February 2006 to April 2008, is a consortium owned by both Naftohaz and RosUkrEnergo and the monopolist of imported natural gas, sold at market prices; Naftohaz remained as the monopolist of natural gas produced in Ukraine, sold at subsidized prices but as we will have the occasion to see in debt disputes, Naftohaz also bought some of UkrGazEnergo's natural gas, as internal production was not enough. An added element of complexity stems from the fact that while RosUkrEnergo sold all imported gas to Naftohaz, it secured some volumes to be reexported in Europe; these volumes were either sold directly by RosUkrEnergo, or sold through Gazexport or other filials belonging to Gazprom.

The short sum-up above may serve the reader to understand better these complex relations when they are explained in the following chapters. Besides this, we may close this short introduction reminding two important sets of information that will be derived from chapters 6-8: from one side, we will

determine to what degree the outcomes in the three disputes can be credited by either Ukraine or Russian decisions. For this reason, analyses will be devoted to consider whether Gazprom won or lost these disputes; Gazprom's having won all three disputes would leave the different pattern of escalation to be explained by lesser or higher resistance from the side of Ukraine. On the contrary, if Gazprom accepted different outcomes, this would open the door to consider Russia and Gazprom evolving in each of the three disputes along different degrees of risk-acceptance or risk-aversion. If these three chapters will provide us with as much information as possible regarding the disputes outcomes, it should also provide as with information as for how the status quo was evolving, either improving or eroding, as a clue to link Gazprom's different decisions, reflected in different patterns of escalation, following prospect theory assumptions that perspectives of impending losses drive actors to assume more risks.

Each chapter will finish with a short sum-up of conclusions regarding "who won the disputes", as well as hints of which elements might be present that fit prospect theory based explanations. An additional chapter, chapter 9, will close this part summing conclusions regarding the disputes outcomes, whereas all elements pertaining to prospect theory based explanations will be developed in our conclusions, in chapter 11, after Part IV and chapter 10 deal with the risk factor.

Chapter 6: Russia-Ukraine Energy Dispute of January 2006

With the arrival in 2005 of Viktor Yushchenko as President of Ukraine, a series of changes happened that contributed to ultimately provoke the dispute of January 2006 and thus opened a period of instability in Ukrainian-Russian energy relations. Attempts at renegotiation between Ukraine and Russia were started by Ukraine and then deepened by Russia during the year 2005. However, other changes exogenous to Russo-Ukrainian relations also played a determining role with Turkmenistan, which exported half of the gas imported by Ukraine, pursuing a different energy policy. If that was not enough, we must mention other factors deriving from the complex pattern of energy relations which included other third actors, in this case intermediary companies like "RosUkrEnergo" (RUE), which monopolized imports of Turkmen gas to Ukraine and which would eventually have a relevant role in the agreements reached as an outcome of the January 2006 dispute.

6. 1. Turkmenistan's Energy Policy

As early as at the beginning of December 2004, Ashgabat had been hinting at a price hike, for both Russia and Ukraine, from the current price of US\$44tcm to US\$60tcm. In the face of both countries' opposition, Turkmenistan's President Saparmurat Niyazov decided on 31st December to stop supplies in order to "carry out repairs" in the gas pipelines in its territory. It is safe to think that the intended repairs were an excuse used as a negotiating instrument in a clear hardening of Turkmenistan's position. Russia insisted upon the contract it had previously signed with Turkmenistan on the 10th April 2003 and which had a validity of 25 years¹ and refused to yield. Shipments were eventually renewed after 11 days, while both countries still had to solve the dispute² (in fact, it would take some more weeks before normal supplies to Russia were reestablished).

Ukraine, as a mere recipient of gas from Turkmenistan and not a country which as Russia, enjoyed by that time a position of monopsony in relation to Central Asian gas producers,³ was arguably in a less

¹ That agreement foresaw a gradual increase of gas exports to Russia from 4-5bcm in 2004 to 70-80bcm from 2009, with 2007 being the big turning point, as exports would jump from 10bcm in 2006 to 60-70bcm (see: Fredholm, Michael: "Natural-gas Trade between Russia, Turkmenistan, and Ukraine: agreements and disputes", Stockholm University, Asian Cultures and Modernity, *Research Report*, no. 15 (15 Nov. 2008), at <http://gpf-europe.com/upload/iblock/2fa/fredholm.ukraine.russia.gas.rr15.pdf>.

² *Ibid.*

³ Excepting Iran and from 2009, China too, the only way for Turkmenistan to sell its gas to consumers in Europe was to use Russia's pipelines. In the case of Uzbekistan and Kazakhstan, the situation is similar. Kazakhstan managed to link with China

favorable negotiating position. This vulnerability was made even worse as Gazprom decided it could not compensate Naftohaz for the expected shortages,⁴ meaning it would suffer shortages if the company did not yield to Turkmenistan's pressure. Ukraine thus soon agreed for a price of US\$58tcm,⁵ almost as much as Turkmenistan was asking for;⁶ this arguably represented a high potential for instability as it would force Ukraine to review its energy policy. The new leadership in Ukraine by the President Viktor Yushchenko and his Prime Minister Yulia Timoshenko would soon try to modify that recent agreement and reach a more favorable one.

Ukraine attempts to revise prices with Turkmenistan

The first occasion for revision came on March (22nd to 23rd), when President Yushchenko carried out his first official visit to Turkmenistan since his inauguration.⁷ The aim was to revert to the bilateral contract in force which regulated Turkmen imports to Ukraine of 2002-2006, agreed in May 2001 and which secured 36bcm of annual imports under prices subjected to annual renegotiation but which were expected to remain at US\$44tcm.⁸ The main proposal "in exchange" for reverting to previous conditions was an

through an oil pipeline completed in 2009. Since 2007 both countries are also developing gas pipelines which are breaking the country's monoposonic dependence on Russia.

⁴ This was communicated to Naftohaz on 31st December. Gazprom stated that it could not ensure supplies of up to 36bcm gas as expected for the year 2005 from Turkmenistan. Rejecting this interpretation of the contract, Naftohaz's Head, Iurii' Boi'ko, claimed that Gazprom, according to oral agreements, had to ensure the supply of 21bcm of gas from Central Asia if no contract was in force (Grib, Natal'ia and Glumskova, Elena: "Druzhba narodov. Turkmeniia nagrela Ukrainu na gaze (Дружбанародов. Туркмени янагрела Україну на газе)", *Kommersant*, January 11 2005 (Accessed on the 20th August 2011 from East View, Harvard Libraries). View also: Eremenko, Alla: "Turkmenskii' Sindrom (Туркменский синдром)", *Zerkalo Nedeli*, 15 January 2005, at

http://zn.ua/ECONOMICS/turkmenskiy_sindrom-42259.html). This move, as could have been expected, was viewed by some in Ukraine as a proof of Russian motivations to "punish" Ukraine for its choice in the last elections.

⁵ Once the border between Russia and Ukraine was reached, the final price should have amounted to around US\$74tcm, quite unsustainable for the Ukrainian economy (see: "Natsional'nyi' Interes. Iushchenko podstrakhavalsia (Национальный интерес. Ющенко подстраховался)", *Rossii'skie Vesti*, 30 March 2005 (Accessed on the 20th August 2011 from East View, Harvard Libraries).

⁶ Shevel'kova, Oksana: ""Turkmenbashi igraet na trube "Gazproma" (Туркменбаши играет на трубе "газпрома")", *Gazeta*, 11 January 2005 (Accessed on the 22nd August 2011 from East View, Harvard Libraries). The new arrangement, agreed on 3rd January, soon raised critics: As relayed by *Ukrainska Pravda*, some analysts, as Mikhail Gonchar, former vice-president of the "Eurasian oil corridor project", considered in an interview to *Deutsche Welle*, that "the unexpected price hike of natural gas carried out by Turkmenistan represents a serious mistake of "Naftohaz Ukrainy". (see: "Glavu Naftogaza obviniaut v oshibochnykh otnosheniiakh s Turkmenbashi (Главу "Нафтогаза" обвиняют в ошибочных отношениях с туркменбаши)", *Ukrainskaia Pravda*, 5 January 2005, at

<http://www.pravda.com.ua/rus/news/2005/01/5/4384576/> (Accessed on the 25th June 2012). Some analysts preferred to make a more optimistic assessment of the agreement, such as another expert on energy, Mikhail Kukhar, who nevertheless hinted at the fact that such an increase had necessarily to be compensated for by some other provisions that would justify it (*Ibid.*).

⁷ "President Yushchenko meets Turkmenbashi to talk natural gas", *Kyiv Post*, 24 March 2005, at <http://www.kyivpost.com/content/ukraine/president-yushchenko-meets-turkmenbashi-to-talk-na-22504.html> (Accessed on the 25th June 2012).

⁸ The Vice-Prime Minister Anatoli Kinakh, sceptical as to the capacity to change the agreement, pointed to internal reforms that might after all compensate the impact of the recent increase (Sizontova, Simona: "Gazovaia lovushka dlia Iushchenko. Deklariruiia orientatsiiu na Zapad, «oranzhevyi» prezident edet za resursami na diktatorskii' Vostok (Газовая ловушка для Ющенко. Декларируя ориентацию на Запад, «оранжевый» президент едет за ресурсами на диктаторский Восток),

offer for a consortium in which Ukraine, Germany and Poland, would participate. The goal of the consortium (according to what had been stated by Alexei Ivchenko, new Head of Naftohaz) would be to purchase Turkmen gas for re-export to Europe. The Minister of Energy Affairs, Ivan Plachkov, made very unrealistic declarations pledging a doubling of imports⁹ to Ukraine from Turkmenistan in the current year.¹⁰ According to sources reached by *Kommersant*, it seems that Ukraine, more realistically considered prices between US\$50tcm to US\$52tcm instead of US\$44tcm as before.¹¹

However, Ashgabat stayed firm in its intention and maintained the recent unilateral revision of prices. If the initiative of a consortium was endorsed, it was also put forward that the Russian side should be included. That was equal to nipping in the bud a proposal which Moscow was obviously not predisposed to support, as this project was meant for Ukraine to bypass Russia (which in any case, seemed impossible for strictly geographical reasons)¹². The acceptance (at least rhetorically) of this project came along with a promise by President Saparmurat Niyazov to dramatically increase exports to Ukraine in order to reach a figure of 60bcm¹³ (roughly the same amount promised to Russia). This additional proposal though, was also very unrealistic as gas extraction had been dwindling in 2005 for the second consecutive year, and long-term prospects for huge extraction increases were still dubious.¹⁴ The price for gas for Ukraine remained but quite real and was left for further negotiations.

Nezavisimaia Gazeta, 22 March 2005 (Accessed on the 22nd August 2011 from East View, Harvard Libraries); his position however, was minority.

⁹ Turkmenistan had indeed projects for nearly doubling its current capacity to 120bcm in 2010, thus enabling substantial exports to both Russia and Ukraine. As Vladimir Socor stated in his analysis in "Eurasia Daily Monitor", that was a realistic prospect indeed, that did not require too onerous investments, though hardly realizable in 2005, and dubious after all, given the fact that in 2004 and 2005, extraction volumes had declined (see: Socor, Vladimir: "Yushchenko proposes international consortium for Central Asian gas", *Eurasia Daily Monitor*, vol. 2, no. 38 (23 March 2005), at [http://www.jamestown.org/single/?tx_ttnews\[tt_news\]=27743&no_cache=1#.VR7QQOFPU5w](http://www.jamestown.org/single/?tx_ttnews[tt_news]=27743&no_cache=1#.VR7QQOFPU5w) (Accessed on the 2nd September 2012); Torbakov, Igor: "Ukraine, Turkmenistan Probe Gas Deal", *EurasiaNet*, 4 April 2005, at <http://www.eurasianet.org/departments/business/articles/eav040505.shtml> (Accessed on 3rd September 2012).

¹⁰ Glumskova, Elena; Chernikov, Andrei and Stokan, Sergei: "Druzhiba narodov. S gazu na gaz pogovorili prezidenty Ukrainy i Turkmenii (Дружба народов. С газу на газ поговорили президенты Украины и Туркмении)", *Kommersant*, 23 March 2005 (Accessed on the 24th August 2011 from East View, Harvard Libraries); Such declarations could have been intended as posturing against Russia.

¹¹ Chernikov, Andrei and Glumskova, Elena: "Druzhiba narodov. Viktor Iushchenko uexal bez skidki (Дружба народов. Виктор Ющенко уехал без скидки)", *Kommersant*, 24 March 2005 (Accessed on the 22nd August 2011 from East View, Harvard Libraries).

¹² The idea behind this was probably to build new pipelines with no, or at least limited ownership by Gazprom and thus do without the Russian company's transit monopoly.

¹³ *Ibid.*

¹⁴ Most of the optimistic assessments relied on the volumes of gas reserves in the huge South Yolotan field; however, many mistrusted the figures of 5Tcm, coming from non-reliable Turkmen authorities, whereas Russian specialists preferred to talk of something around 2.6Tcm to 2.7Tcm. It was not until October 2008 when reliable figures that matched the early Turkmen estimates were released (see: Fedorov, Iurii: "The Turkmen gas games", *Security Index: A Russian Journal on International Security*, vol. 16, no. 3 (2010), p. 42), pointing to a maximum of 14Tcm.

New attempts at renegotiation from April 2005

After this first failure, negotiations soon resumed in early April with the Ukrainian side trying again to push Turkmenistan to accept a new pricing formula. This new round started with the visit to Kiev of a delegation of "TurkmenNefteGaz". Yushchenko this time changed the strategy, expressing his respect for the controversial agreement.¹⁵ Then Naftohaz, instead of a price reduction, tried this time to change the frame under which payments were made to Turkmenistan: so far, Ukraine had been paying for gas through a mixed formula, namely, 50% of the payments in cash and the remaining 50% through obscure frameworks of barter. What Ukrainian negotiators were now putting forward was to make payments only in cash. They calculated in fact that if doing so, the real price would automatically revert to something similar to that prevailing in 2004. According to calculations by experts from Naftohaz, the final price that Ukraine paid for gas at the Russo-Ukrainian border, after costs of transportation through Uzbekistan, Kazakhstan and Russia were added, amounted to close to US\$61tcm, when prices of origin were US\$44tcm; with the new price at US\$58tcm, final prices would amount to only around US\$63tcm if integrally cash-based payments were introduced.¹⁶

Turkmenistan actually also desired to move to an exclusively cash-based system of payment.¹⁷ As relayed by the authoritative Russian daily *Kommersant* on the eve of a trip to Turkmenistan by a delegation from Naftohaz to pursue discussions on energy, the delegation wanted to thwart the agreement Russia and Turkmenistan had signed in 2003 covering the period 2006-2026 and which foresaw that Gazprom would become the importer of all Turkmen gas production starting in 2007.¹⁸ They planned to propose a renewal of the current agreement between Ukraine and Turkmenistan, to expire in 2006, with Ukraine importing 50bcm to 60bcm instead of the current 38bcm and thus making the country fully independent from Russia. The project also included the possibility of reviewing the framework of intermediation so far, since 2005 covered by the shady company RosUkrEnergo, which was owned 50/50

¹⁵ He went as far as to say: "If someone considers, that my main duty was travelling to reduce the price, I give you my word, I will never deal with prices" ... "It has been settled (referring to the current price), formalized, there is a contract which has been agreed based on it, and there is national budget (Turkmenistan) relying on it" ... "it is not a President's business to abandon this proposal" (Grivach, Alexei': "Barternyi' rynek. Ukraina torguetsia s Turkmenbashi" (Бартерный рынок. Украина торгуется с Туркменбаши), *Vremia Novosti*, 1 April 2005 (Accessed on the 22 August 2011 from East View, Harvard Libraries); Fokina, Ekaterina: "V Fokuse. Gazovaia ataka Ukrainy (В фокусе. Газовая атака Украины)", *Profil*, 4 April 2005 (Accessed on the 26th August 2011 from East View, Harvard Libraries).

¹⁶ *Ibid.*; we may doubt this price calculation, as usual calculations of transportation costs range around US\$30tcm.

¹⁷ Butrin, Dmitrii'; Chernikov, Andrei' and Kukhar, Mikhail: "Ukraina zakupit turkmenskii' gaz uzhe prodannyi' "Gazpromu" (Украина закупит туркменский газ уже проданный "Газпрому")", *Kommersant*, 4 April 2005, at <http://kommersant.ru/doc/570127> (Accessed on the 3rd September 2012).

¹⁸ See: Tell, Rustem: "Turkmenskii' gaz poi'det v Rossiю (ТУРКМЕНСКИЙ ГАЗ ПОЙДЕТ В РОССИЮ)", *Tribuna*, 16 April 2005 (Accessed on the 22nd August 2011 from East View, Harvard Libraries). This would leave Ukraine in danger of being at the "mercy" of Gazprom for all its shipments of Turkmen "blue gold".

by Gazprom and the Austria-based "Raiffeisen Investments". Besides that, the possibility for establishing a consortium was mentioned again with the added proposal to build a new pipeline crossing Uzbekistan, Russia and Ukraine which would enable Turkmenistan's shipments to reach Europe.¹⁹

These plans however were soon thwarted by the Head of Gazprom, Alexei Miller, who paid a visit to Turkmenistan on 15th April. The result of their talks was that, in spite of Turkmenistan having accepted the Ukrainian proposal as seen above, the reclusive country now renewed its support to the agreements signed so far with Russia (Gazprom would control the Turkmen gas market by 2007), which would necessarily lead to Turkmenistan's shipments to Ukraine being monopolized by Gazprom's unavoidable intermediation.²⁰ If that was not enough, Gazprom managed to finally put an end to the controversy with Turkmenistan regarding their still unresolved pricing dispute and which cleared the resumption of shipments, stalled since Russia had refused to yield to pressure.²¹ Gazprom's delegation agreed to make payments exclusively on a cash-based basis, favored by Turkmenistan, who in exchange accepted to leave prices unchanged at US\$44tcm.²² As Roman Kupchinski pointed out, the success that Russia had at least apparently achieved, was radically contrary to Ukraine's plans²³ and the situation was arguably poised to complicate the race between both of them for primacy in the market of Turkmen gas exports. With an expected visit by Prime Minister Yulia Timoshenko to Ashgabad not materializing, this left Ukraine in a state of clear indecision.²⁴

¹⁹ Butrin, Chernikov and Kukhar, *op. cit.* The weakness of this proposal was that it depended on Russia. as the Minister of Energy of Ukraine, Ivan Plachkov would eventually declare to the weekly *Zerkalo Nedeli*: "We offered Russia a new conception for developing a Transport Consortium through the participation of other countries apart from the Russian Federation and Ukraine. So far Russians have not clearly responded" (see: Eremenko, Alla: "Ivan Plachkov: glavnaia zadacha Mintopenergo – stabil'noe obespechenie potrebitel'ei energonositeliami i elektroenergei' (Иван Плачков: «Главная задача Минтопэнерго — стабильное обеспечение потребителей энергоносителями и электроэнергией»)", *Zerkalo Nedeli*, 14 May 2005, at

http://zn.ua/ECONOMICS/ivan_plachkov_glavnaya_zadacha_mintopenergo__stabilnoe_obespechenie_potrebiteley_energono_sitelyami_i-43360.html (Accessed on the 3rd September 2012).

²⁰ Rustem, "Turkmenskii' gaz", *op. cit.*

²¹ Because winter had been unexpectedly warm, this provided for larger volumes of gas available to close up the gap left as a consequence of the dispute. This probably largely explains the firm Russian attitude.

²² Butrin, Dmitrii' and Karat, Dina: "Gazprom oplatit turkmenskii' gaz dengami ("Газпром" оплатит туркменский газ деньгами)", *Kommersant*, 18 April 2005, at <http://kommersant.ru/doc/570939> (Accessed on the 4th September 2012); Shevel'kova, Oksana: "Dogovor Dorozhe Deneg. Peregazirovka (ДОГОВОР ДОРОЖЕ ДЕНЕГ. ПЕРЕГАЗИРОВКА)", *Gazeta*, 18 April 2005 (Accessed on the 24th August 2011 from East View, Harvard Libraries); Watkins, Eric: "Russia, Turkmenistan end gas-price stand-off", *Oil & Gas Journal*, vol. 103, no. 17, 2 May, 2005, pp. 37-38 (Accessed on the 4th September 2012, from ProQuest, Biblioteca UCM).

²³ Kupchinski, Roman: "Ukraine and Russia in spat over Turkmen gas", *Asia Times*, 20 April 2005, at http://www.atimes.com/atimes/Central_Asia/GD20Ag01.html (Accessed on the 4th September 2012).

²⁴ Beyond mentions in a telephone conversation between the President Viktor Yushchenko and his homologue ("Iushchenko i Turkmenbashi pogovorili, kak oni otprazdnuut cherez nedeliu (Ющенко с Туркменбаш ипоговорили, как они отпразднуют через неделю)", *Ukrainskaia Pravda*, 29 April 2005, at

<http://www.pravda.com.ua/rus/news/2005/04/29/4387899/> (Accessed on the 4th September 2012) and during the latter's official visit ("Iushchenko nagradil Niazova posmertno (Ющенко наградил Ниязова посмертно)", *Ukrainskaia Pravda*, 5

Scarce prospects for Ukrainian diversification projects

Failing Turkmen promises, new projects of diversification would prove even less promising. President Yushchenko made a visit to Kazakhstan where most attention was devoted to oil projects, as it was thought that Caspian oil could eventually find a new promising outlet with the inauguration that same month of the Pipeline Baku-Tbilisi-Ceyhan (BTC) in the Turkish Southern coast.²⁵ What exactly was sought in this visit was an agreement to establish a joint company to build a short 52 km long pipeline from the port of Iuzhne to Odessa in order to transport oil coming by sea (from the port of Ceyhan), while it was also hoped that Naftohaz would be invited to develop oil fields in Kazakhstan.²⁶ The project would never materialize.

Later on, it was the turn for Prime Minister Timoshenko to announce another energy breakthrough abroad which was supposed to expand Ukrainian relations with energy producers other than Russia: a deal involving Azeri cooperation to build new refineries in Ukraine.²⁷ Besides that, there was news that Azerbaijan was ready to build a pipeline that could eventually transport natural gas from Turkmenistan or Iran to Ukraine.²⁸ At the same time, Timoshenko assured that Kazakhstan was ready to take part in the extension of the pipeline Odessa-Brody into Poland so as to reach either Plock or even Gdansk and transform it into an export outlet to Europe.²⁹ Alexei Ivchenko even spoke of an already agreed upon consortium including Ukraine, Azerbaijan, Georgia and Turkmenistan for the export of Caspian oil through the projected pipeline Baku-Supsa, which could reach Odessa through the Black Sea.³⁰

Triumphant declarations coming from the government conveyed an impression of misplaced optimism that did not match both the fact that these projects were yet nothing but proposals and the fact

May 2005, at <http://www.pravda.com.ua/rus/news/2005/05/4/4387980/> (Accessed on the 4th September 2012), nothing materialized.

²⁵ "Iushchenko budet prosit' u Nazarbaeva nefiti (Ющенко будет просить у Назарбаева нефти)", *Ukrainskaia Pravda*, 30 May 2005, at <http://www.pravda.com.ua/rus/news/2005/05/30/4388728/> (Accessed on the 5th September 2012); However, as the same Ivchenko would have to acknowledge, most Ukrainian refineries were not yet ready to transform light Caspian oil (see: *Ibid.*). Besides that, oil from the Caspian happened not to be similarly priced to Russian gas: US\$300-320tcm per ton for the former vs. US\$305-310tcm for the latter, despite wishful thinking from the part of Ivchenko (see: *Ibid.*).

²⁶ *Ibid.*

²⁷ "Timoshenko nashla, kto mozhет postroit' Ukraine novyi' neftezavod (Тимошенко нашла, кто может построить Украине новый нефтезавод)", *Ukrainskaia Pravda*, 3 June 2005, at <http://www.pravda.com.ua/rus/news/2005/06/3/4388898/> (Accessed on the 5th September 2012). This ran counter to Ivchenko's preference of rather upgrading already existing refineries (see: *Ibid.*; "Iushchenko budet", *op. cit.*).

²⁸ *Ibid.*

²⁹ "Akhmetov poobeshal Timoshenko pomoch' sniat' zavisimost' ot Rossii (Ахметов пообещал Тимошенко помочь снять зависимость от России)", *Ukrainskaia Pravda*, 3 June 2005, at <http://www.pravda.com.ua/rus/news/2005/06/3/4388936/> (Accessed on the 5th September 2012).

³⁰ "U Ukrainy est plokhiaia novost' dlia Rossii (У Украины есть плохая новость для России)", *Ukrainskaia Pravda*, 3 June 2005, at <http://www.pravda.com.ua/rus/news/2005/06/3/4388931/> (Accessed on the 5th September 2012).

of Ukraine's geographical, "landlocked" by Russia and therefore unable to establish a direct contact with producing countries from either Central Asia or the Caucasus. An interview by Ivchenko for *Galitskie kontrakti*, as relayed by *Vremia Novosti*³¹ is a good example of this lack of realism: Ivchenko intended the planned International Consortium to construct a gas pipeline through the beds of both the Caspian and The Black Seas to cross the Caucasus; Naftohaz, at the same time, proposed to Russia to cooperate in the construction of a new gas pipeline from Aleksandrov Gai' (Kazakhstan) to Novopskov (Russia).³¹

Apparent agreement on pricing system with Turkmenistan and debt scandal

In spite of the delicate situation for Ukraine, soon positive news came: after a meeting with Alexei' Ivchenko, President Niyazov eventually agreed to revert to old prices in exchange for payments in cash (Gazprom's securing of this price came after a similar change).³² According to Ivchenko, the switch to this new framework clearly favored Ukraine, as instead of paying US\$2.8bill as in 2004, the new system starting from July would only demand a yearly US\$2.09bill.³³ An explanation of why independently of the reversal to a lower price, the switch in itself to the cash-based system was beneficial, seems to be explained, according to the Head of Naftohaz himself, by the fact that paying a fixed amount in dollars for transit was in fact cheaper than paying with gas, which was later sold at market prices by the intermediary company.³⁴ Other accounts pointed to the benefits accruing to Turkmenistan.

However, on 20th June, right after the first meeting with the incoming delegation from Naftohaz, President Niyazov declared in very harsh terms that Ukraine had incurred in a massive fraud withholding the due payment for gas already shipped from Turkmenistan: According to Ashgabat, there was as much as US\$600mill that had accumulated during 2005, to which had to be added US\$61.7mill of payments due from 2004. The system through which the Turkmen side accused Ukraine to commit fraud was by

³¹ Grivach, Aleksei': "Proekt po-kievski. "Naftogaz Ukrainy" ugrozhaet "Gazpromu" postroit' morskoi' truboprovod v obkhod Rossii (Проект по-киевски. "Нафтогаз Украины" угрожает "Газпрому" построить морской трубопровод в обход России)", *Vremia Novosti*, 27 April 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³² "Ivchenko dogovorilsia o gaze s Turkmenbashi, a Rossiia podnimet tseny (Ивченко договорился о газе с Туркменбаши, а Россия поднимет цены)", *Ukrainskaia Pravda*, 24 June 2005, at <http://www.pravda.com.ua/rus/news/2005/06/24/4389582/> (Accessed on the 14th September 2012); "S 1 Iuliia Ukraina budet pokupat' turkmenskii' gaz za "zhivye" dollar (С 1 июля Украина будет покупать туркменский газ за «живые» доллары)", *Zerkalo Nedeli*, 25 June 2005, at http://zn.ua/POLITICS/s_1_iyulya_ukraina_budet_pokupat_turkmenskiy_gaz_za_zhivye_dollary-43799.html (Accessed on the 14th September).

³³ "Rossiia obidelas' na Ukrainu za soglasenie s Turkmenbashi (Россия обиделась на Украину за соглашение с Туркменбаши)", *Ukrainskaia Pravda*, 26 June 2005, at <http://www.pravda.com.ua/rus/news/2005/06/26/4389633/> (Accessed on the 14th September). According to the Ukrainian side, this agreement actually was better than what had been proposed by Ukraine in April, where the switch to cash based payments would be made on the basis of US\$58tcm, while this time, prices moved back to US\$44tcm. It seemed to be optimal even in relation to conditions existing prior to 1st January 2005 (see: Grivach, "Barternyi'", *op. cit.*)

³⁴ "Rossiia obidelas'", *op. cit.*

overpricing the industrial products which were provided in barter; instead of a coefficient of 1.5, Turkmenistan claimed that Ukraine had been applying a favorable coefficient of 2.8.³⁵ Thanks to these coefficients, Ukraine had been actually paying a real price of US\$30-32tcm with the nominal price of US\$44tcm. Now, according to a calculation from *Kommersant*, Ukrainian companies³⁶ would have to pay US\$90tcm for natural gas (at the Ukrainian border, once the costs for transportation were added), compared to US\$65tcm, as enjoyed before.³⁷ Following assessments by *Vremia Novostei*, when Ukraine had accepted a nominal price of US\$58tcm, the real price at the Turkmen border was still a quite comfortable US\$40tcm thanks to the perverse effect of the manipulated coefficient.³⁸

6. 2. Russo-Ukrainian Energy Relations

Without real prospects for Ukraine to impose a real break with the energy policies of the latest years under Kuchma's Presidency and to turn away from energy dependence on Russia, Kiev's idealism would prove particularly misplaced during the next months, the January 2006 gas crisis being, as we will have the chance to see below, the ultimate proof. In June, Ukraine witnessed the first stage of a process of deterioration in bilateral Russo-Ukrainian energy relations. The reasons for dispute centered on the existing agreements that shaped the current regime of energy relations and determined both prices of Russian gas and the transit tariff Ukraine imposed on gas transiting the country to the rest of Europe.

Ukraine proposes a renegotiation of the transit tariff and Gazprom proposes new prices

The first divergences had in fact started much earlier, when Ivan Plachkov and Alexei Ivchenko visited Moscow in late March to confer with their Russian partners from Gazprom. Ivchenko started by putting forward the elimination of intermediaries that managed the shipments of gas between Turkmenistan and

³⁵ Butrin, Dmitrii and Grib, Natal'ia: "Druzhiba narodov. Ukrainu udarili po gazam (Дружба народов. Украину ударили по газам)", *Kommersant*, 22 June 2005 (Accessed on the 23rd August 2011, from East View, Harvard Libraries); Gorina, Ivanna: "Skandal "podruzhbe" (Скандал "подружке")", *Rossii'skaia Gazeta*, 22 June 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

³⁶ It must be reminded that the population was supplied by cheap gas produced in Ukraine itself, while companies were mostly supplied with shipments coming from Turkmenistan.

³⁷ Gavrish, Oleg and Lambaeva, Renata: "Druzhiba narodov. "Naftogaz Ukrainy" sdalsia Turkmenii (Дружба народов. "Нафтогаз Украины" сдался Туркмении)", *Kommersant*, 27 June 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³⁸ Grivach, Alexei: "Po puti Rossii. "Naftogaz" lishil ukrainskikh proizvoditelei' turkmenskogo rynka (По пути России. "Нафтогаз" лишил украинских производителей туркменского рынка)", *Vremia Novostei*, 27 June 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries). In this article's assessment, no comparison appears regarding final prices for Ukrainian consumers, although it does imply that the new deal meant an improvement for Turkmenistan, even compared to that based on the nominal price of US\$58tcm. According to previous assessments mentioned here, the final price under such an agreement would amount to around US\$78tcm. That indeed would confirm that Turkmenistan had again increased its benefits at the expense of Ukraine.

Ukraine (As already stated, since 2005 transit was monopolized by the company RosUkrEnergo) and proposed to place the business of intermediation in the hands of Gazprom and Naftohaz.³⁹

But Ivchenko also proposed changes in the regime of transit tariffs, namely (in parallel to what was happening with Turkmenistan), to transform the barter system of payment into one where the totality of payments would be made in cash.⁴⁰ The concrete proposal that the delegation seems to have put forward, was to raise the transit tariff to US\$1.75-2tcm/100km from the US\$1.09tcm/100km set at the moment (It was calculated that the new prices Ukraine might end up paying for Russian gas could increase from US\$50tcm to US\$80tcm),⁴¹ while Yushchenko himself would later mention another price: US\$2.73-US\$2.80tcm/100km.⁴² Gazprom did not commit itself and welcomed the proposal regarding the intermediation for Turkmen gas, saying that as long as they would secure half of the transit of Turkmen gas, they could agree in principle with their counterparts.⁴³ However, regarding the proposal of transition into a cash-based system for paying transit tariffs for Russian gas transiting Ukraine, Gazprom not only

³⁹ Egorova, Tatiana and Reznik, Irina: "Gazprom prosiat podelit'sia ("Газпром" просят поделиться)", *Vedomosti*, 29 March 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁴⁰ *Ibid.* According to the daily *Vedomosti*, analysts concurred in considering the deal beneficial for Russia; as Maksim Moshkov, analyst from Brunswick UBS, explained: "Barter payments with 'Naftogazom' took the price of US\$50tcm as a basis, whereas now Russia could resell 24 additional bcm to Europe (Gazprom itself calculated around 23bcm) at a higher price of around US\$140-US\$150tcm" (see: "On Alexey Miller's meeting with Ivan Plachkov and Alexey Ivchenko", *Gazprom News*, 28 March 2005, at <http://www.gazprom.com/press/news/2005/march/article63040/> (Accessed on the 6th September 2012). Following some calculations, such a change could have yielded Gazprom some US\$2.9bill more in profits (see: Egorova and Reznik, *op cit.*) and as a press release from "Gazprom" on 28 March, stated: "We can't but welcome the Ukrainian side's aspirations to ensure the maximum transparency and market-based mechanisms of interaction between the firms. We're backing the Ukraine's proposal to shift over to settling gas transit via the Ukraine services in cash and to increasing the gas transmission tariff rate to the level adopted in Europe" (see: "On Alexei Miller's", *op. cit.*).

⁴¹ Iudina, Liudmila: "Bez bartera (БЕЗ БАРТЕРА)", *Trud*, 30 March 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries). That new price for Russian gas was also considered as most likely by the authoritative daily *Kommersant*, which also calculated the additional costs which this would entail for Ukraine: US\$690 million per year (see: Butrin, Dmitrii' and Grib, Natal'ia: "Druzhba narodov. Peregazirovka (Дружба народов. Перегазировка)", *Kommersant*, 29 March 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries): suppressing the barter system and switching to cash based payments for the transit fees would be beneficial for Russia, possibly yielding up to US\$2.9 more billion. However, if Ukraine managed to raise the nominal transit fee at the proposed prices, which involved at least a 2/3 increase, the question was to know whether such move would not end up restoring the beneficial conditions prevailing for Ukraine (see: Iudina, *op. cit.*).

⁴² Orekhin, Piotr and Zaets, Ilona: "Iushchenko ne khochet ssorit'sia s 'Gazpromom'. No ochen' khochet podvinut' ego na evropei'skom gazovom rynke (Ющенко не хочет ссориться с «Газпромом». Но очень хочет подвинуть его на европейском газовом рынке)", *Nezavisimaia Gazeta*, 31 March 2005 (Accessed on the 19 August 2011, from East View, Harvard Libraries).

⁴³ Egorova and Reznik, *op. cit.* It must also be stated that according to some other sources, Gazprom seemed to be somehow skeptical regarding the feasibility thereof, something that the Ukrainian delegation would have accordingly acknowledged, as Naftohaz would have needed to enter RosUkrEnergo and buy the total of the stakes owned by the obscure "Raiffeisen Investment" (see: Grivach, Alexei': "Rynochnoe sosiedstvo. 'Gazprom' gotov vkluchit' Ukrainu v Evropu (Рыночное соседство. 'Газпром' готов включить Украину в Европу)", *Vremia Novostei*, 29 March 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

agreed, but it also concluded that this opened the door to payments based on market prices also for Ukrainian imports of Russian gas; Naftohaz had opened Pandora's box.⁴⁴

Gazprom's countermove was far from being expected by the Ukrainian delegation.⁴⁵ Viktor Yushchenko himself justified the proposal as aimed against intermediaries,⁴⁶ as he had already stated in Turkmenistan.⁴⁷ However, it is at first sight difficult to link the role of RosUkrEnergo, dealing with Turkmen gas in transit to Ukraine (RosUkrEnergo was responsible for importing 37bcm of Turkmen gas to Ukraine, from which RosUkrEnergo kept 13bcm in kind as transit tariff,⁴⁸ that is, 37.5% of the whole amount),⁴⁹ to a much different matter, which is the tariff for transit of Russian gas to Europe through Ukraine. In any case, after the president made his declarations, according to the Russian daily *Nezavisimaia Gazeta*, Naftohaz issued a statement clarifying that whatever change there might be on the principles of payment for transit, it should not be done before a detailed calculation by Ukrainian experts.⁵⁰ This move looked like an attempt by Naftohaz to stall a process that threatened to get out of hand. The company further pointed out that any initiative to move to cash-based payments should be

⁴⁴ There has always been controversy in this episode, but the fact is that, as surprising as it may sound, the Ukrainian side, as it started to transpire later, did not expect a Russian counterproposal in kind (see: Vin'kov, Andrei' and Rubanov, Ivan: "Russkii' Biznez / Torgovlia gazom. Konflikt iz podzeml'ia (РУССКИЙ БИЗНЕС / ТОРГОВЛЯ ГАЗОМ. Конфликт из подземелья)", *Expert*, 4 July 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries); As Putin would later in December state himself: "*Our Ukrainian partners have been the most vigorous supporters themselves of this proposal (The transition to market calculations for gas. - Ed.) and were their main initiators*" (see: Grivach, Alexei': "'Schet idet nailliardy'" ("Счет идет на миллиарды"), *Vremia Novostei'*, 9 December 2005 (Accessed on the 26th August 2011, from East View, Harvard Libraries). More graphic in his explanation was Konstantin Zatulin, Representative of the Russian Duma: "*The initiative to review gas prices came, in fact, from the Ukrainian side, which since Yushchenko came to power, spoke of the need to pay for transit in 'live' money, not gas. Russia took advantage of this opportunity and put the question differently, stating its desire to go to European market prices for gas supplies to Ukraine*" (see: Alexandrov, Sergei': "Vorovstvom grozit Ukra'ina (ВОРОВСТВОМ ГРОЗИТ УКРАИНА)", *Literaturnaia Gazeta*, 14 December 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

⁴⁵ Some news suggested that the Ukrainian delegation had actually also proposed market prices for Russian gas (see: Grivach, "Rynochnoe", *op. cit.*), but the most common version points to Gazprom; according to *Trud*, Naftohaz pretended to review the contracts agreed in 2004 and chose this proposal as the first step (see: Iudina, *op. cit.*); another version by *Vremia Novostei'* is that Ukraine intended the proposal as pressure against Russia, but miscalculated the move (see: Grivach, "Proekt po-kievski", *op. cit.*).

⁴⁶ His words were: "*Our initiative is not aimed against 'Gazprom', but against those agents who work on his behalf and apply the former formula not complexly, but selectively*" (see: Orekhin and Zaets, *op. cit.*).

⁴⁷ Butrin, Chernikov and Kukhar, *op. cit.*

⁴⁸ See: Pavel, Ferdinand: "The Ukrainian-Russian gas agreement: analysis and alternatives", Harvard Ukrainian Research Institute (HURI), *The Ukr-Rus Gas Crisis and Its Aftermath*, Harvard, Boston (5 Feb. 2006), at <https://www.youtube.com/watch?v=iXuzSx-QbeM> (Accessed on the 15th November 2012).

⁴⁹ For that figure, see: Frolov, Aleksandr: "Skhemy-Prizraki (СХЕМЫ-ПРИЗРАКИ)", *Sovetskaia Rossiia*, 12 January 2006 (Accessed on the 24th August 2011, from EastView, Harvard Libraries); Kukhar, Maksim: "Kto prodast gaz v Evropu. Peredel gazovoi' karty Starogo Sveta mozhnet proizoi'ti v blizhai'shie polgoda (Кто продаст газ в Европу. Передел газовой карты Старого Света может произойти в ближайшие полгода)", *Zerkalo Nedeli*, 13 August 2005, at http://zn.ua/ECONOMICS/kto_prodst_gaz_v_evropu_peredel_gazovoy_karty_starogo_sveta_mozhet_proizoyti_v_blizhayshi_e_polgoda-44253.html (Accessed on 15th November 2012); Dmitriev, Vladimir: "Ukraina pered vyborom (УКРАИНА ПЕРЕД ВЫБОРОМ)", *Moskovskii' Komsomolets*, 17 February 2006 (Accessed on the 26th August 2011, from EastView, Harvard Libraries); the fee had been 41% for Itera and 38% for ETG.

⁵⁰ Orekhin and Zaets, *op. cit.*

taken on Gazprom's initiative, even if Naftohaz was responsible for a set of proposals that after all, it had itself initiated.⁵¹ The Russian daily *Vremia Novosti* pointed to possible internal divergences within Ukraine, as the Prime Minister Yulia Timoshenko was opposed to putting an end to cheap prices for natural gas.⁵²

The stored gas controversy between Gazprom and Naftohaz and gas deficit

Alexei Miller's April visit was a rebuke to Ukrainian projects, with the Head of Gazprom stating that no further supplies were to be expected beyond those contracted and inviting Ukraine to maintain cooperation within the existing framework of RosUkrEnergo (Gazprom remained open to Ukraine's recent plans to gain for Naftohaz stakes in RosUkrEnergo from the Austrian "Raiffeisen Investment").⁵³ However, the meeting was even more important for a new controversy that arose between Gazprom and Naftohaz, to unfold in the coming weeks and to further strain bilateral relations:

Gazprom revealed that from October 2004 to March 2005, 7.6bcm of natural gas located in Ukrainian storage facilities owned by the Russian monopoly had disappeared.⁵⁴ These volumes of gas had been stored in Ukraine with the goal of being later re-exported. The fact is that upon repeated requests by Gazprom to pump the gas out of the storages, Ukrainian authorities refused to proceed, alleging several reasons (which were the reasons, was not said by *Kommersant*'s article, the first to report on this incident). The mystery lay in the fact that Gazprom could certify that the amount of natural gas had not been exported and Naftohaz stated that it had not been transported any further. The basis for Russian gas to be stored in Ukraine was an agreement reached between the two state monopolies to provide a "buffer"

⁵¹ *Ibid.*

⁵² Grivach, Aleksei: "Glavnyi po gazu. Viktor Iushchenko lichno vedet kommercheskie peregovory s Alekseem Millerom (Главный по газу. Виктор Ющенко лично ведет коммерческие переговоры с Алексеем Миллером)", *Vremia Novosti*, 28 April 2005 (Accessed on the 26th August 2011, from East View, Harvard Libraries). As the same article points out, Timoshenko's government's intentions to approve a deficitary budget, where new resources would be needed, favored mainly more "fresh money" coming from Naftohaz, something that would be easier if the latter started receiving payments for tariffs in cash and not through barter. The contradiction, suggested the article, was covered so far by a credit line offered by "Deutsche Bank" to the state monopoly.

⁵³ Grivach, "Glavnyi po gazu", *op. cit.*; Butrin, Dmitrii and Chernikov, Andrei: "'Gazprom' pred'iavil Ukraine revoliutsionnye scheta ('Газпром' предъявил Украине революционные счета)", *Kommersant*, 28 April 2005, at <http://kommersant.ru/doc/574027> (Accessed on the 10th September 2012).

⁵⁴ Butrin and Chernikov, *op. cit.* This news is also later reproduced in: "Poka Iushchenko stoial na Mai'dane, u Rossii isparilis' 7.6 b.c.m. gas (Пока Ющенко стоял на Майдане, у России испарились 7,6 млрд кубометров газа)", *Ukrainskaia Pravda*, 28 April 2005, at <http://www.pravda.com.ua/rus/news/2005/04/28/4387847/> (Accessed on the 11th September 2012). It must be noted that according to press reports, the figure would slightly differ. In any case in most of the reports, it always ranged from 7.6bcm to 7.8bcm. These figures will accordingly change in the main text according to the news report referred to. The final figure seemed to be 7.8bcm, finally confirmed in July by the Ukrainian custom officers (see: "Rosii'skii gaz nashli ukrainskie tamozhenniki (Российский газ нашли украинские таможенники)", *Ukrainskaia Pravda*, 6 July 2005, at <http://www.pravda.com.ua/rus/news/2005/07/6/4389923/> (Accessed on the 26th September 2012), even if there already seemed at that time to be a certain consensus in that respect, as most press reports relayed that figure.

of gas to be supplied in case of consumption peaks. When this happened in winter 2004-05, Naftohaz failed to answer to Russian orders to pump the amount of gas in question, stored since 2003.⁵⁵ Facing this anomalous situation, Gazprom offered to sell the gas to Ukraine as compensation.⁵⁶ Even if Timoshenko initially rejected any responsibility and blamed this incident on the previous administration (contradicting Ivchenko's excuses assuring that the amount of gas was still stored in Ukraine),⁵⁷ Naftohaz finally agreed to buy the gas⁵⁸ (it was revealed at the end that the gas stayed in place and had not disappeared as initially suspected)⁵⁹.

Still, an additional complication surfaced: as this volume of natural gas was meant for exportation, Gazprom expected Naftohaz to pay for it at European market prices. The latter refused, so Gazprom offered an alternative through a complicated scheme: gas would be counted as part of the payment for transit for 2005, so Gazprom, instead of paying 23bcm of gas in concept of transit tariff, would only pay 15bcm. This posed a new problem for Naftohaz, as it already faced a gas deficit for which the "missing" gas would be suitable.⁶⁰ This deficit of 8bcm (that closely matched the gas in dispute) originated for the

⁵⁵ Vin'kov and Rubanov, "Russkii' Biznez", *op. cit.*

⁵⁶ Butrin and Chernikov, *op. cit.* As later details would transpire, this gas was meant as a buffer to supply customers in the event of an emergency derived from unexpected pick demand. The exact amount that "Gazprom" had supposedly asked Naftohaz to re-export during the Winter 2004-05, to no avail, would later be revealed to be 3.5bcm (see: Grivach, Alexei': "Miller atakoval Ukrainu. Kievu predlozheno platit' za gaz po vysshemu evropei'skomu urovniu (Миллер атаковал Украину. Киеву предложено платить за газ по высшему европейскому уровню)", *Vremia Novostei'*, 7 June 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

⁵⁷ "Temnaia Bukhgalteriiia (ТЕМНАЯ БУХГАЛТЕРИЯ)", *Trud*, 10 June 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

⁵⁸ "Naftogaz Ukrainy vykupit u "Gazproma" ukrainskii' gaz («Нафтогаз Украины» выкупит у «Газпрома» украинский газ)", *Kommersant*, 8 June 2005, at <http://www.kommersant.ru/news/983980> (Accessed on the 12th September 2012).

⁵⁹ From Naftohaz it was stated that newly found documentation proved the existence of 9bcm of gas located in Ukrainian storage facilities, among which, 7.9bcm (new divergence), were of Russian ownership (see: Grivach, Alexei': "Ukraina nashla rossiiskii' gaz. No khochet platit' za nego v rassrochku (Украина нашла российский газ. Но хочет платить за него в рассрочку)", *Vremia Novostei'*, 14 June 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries). It must be pointed out however, that as Mr. Valerii' Iazev, President of the Committee on Energy in the Russian Duma, stated in an interview, "we could not search in the 12 storage facilities, in which, as confirmed by the Ukrainian side, the Russian gas is located" (see: Naumov, Igor': "Kiev pereotsenil svoi sily. Valerii' Iazev: bol'shaia chast' ukrainskoi' promyshlennosti sliazhnet, esli povysiat'sia tseny na gaz (Киев переоценил свои силы. Валерий Язев: большая часть украинской промышленности сляжет, если повысятся цены на газ)", *Nezavisimaia Gazeta*, 16 June 2005 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

⁶⁰ It was calculated by *Kommersant*, according to experts consulted by the daily, that this would add up and accumulate for Ukraine a prospective deficit of around 10bcm (see: Gavrish, Oleg and Skorobagatko, Denis: "Druzhiba narodov. Vzaimozachet vzaimovychetom (Дружба народов. В заимозачет взаимовычетом)", *Kommersant*, 29 June 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries), even if following other reports, it would amount to even more, 18bcm (see: Grivach, Alexei': "Miller provel zachet. Defitsit gaza na Ukraine dostig 18 mlrd. kubometrov (Миллер провел зачет. Дефицит газа на Украине достиг 18 млрд кубометров)", *Vremia Novostei'*, 29 June 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries). As it would later be clarified, it seems that this was the real deficit Ukraine had to face: the nearly 8bcm stemming from the Russian planned reduction of tariff payments to make up for its gas found in the Ukrainian storage facilities, added up to a preexisting deficit of 10bcm. In theory there should not have been any additional deficit, as the gas claimed by "Gazprom" was located in Ukraine and thus open to use. The presumable problem lay in the fact that Ukraine did not know at that moment the exact location of the missing amount. However, Ukrainian custom officers would later "physically" find the gas and declare that nothing impeded its utilization (see: "Rosii'skii' gaz nashli", *op. cit.*).

following two reasons: Gazprom, as agreed in 2004 with Ukraine, had decided to reduce by 5bcm the supply for 2005 to make up for the debt Ukraine accumulated from 1999. In addition to that, Turkmenistan had for unknown reasons reduced its supply by 3bcm (Naftohaz would eventually agree with Turkmenistan to receive an additional amount of 0.5bcm in payment for works of repair and upgrades done by Ukrainian companies)⁶¹. In fact, as revealed by *Vremia Novosti*, Naftohaz had been discussing buying 5bcm from Gazprom and 3bcm from RosUkrEnergo.⁶² Otherwise, this deficit would be very difficult to close as Turkmenistan could not easily raise its extraction as a compensation, besides the fact that the real Turkmen gas price was to exceed US\$60tcm from June 2005 (see pp. 130-131).⁶³

Instead of this scheme, What Naftohaz proposed was to pay for the gas in its storage facilities in instalments but pegged to the current price of US\$50tcm, something to which Gazprom, used to debts from Ukraine, was not disposed to accept. Another variant which appeared in press reports, was to return the gas itself in instalments with 2008 as deadline, but that also raised a frontal opposition from Gazprom.⁶⁴ As neither Ukraine's proposal nor two of the variants Gazprom had offered so far were satisfactory for any of the counterparts,⁶⁵ no agreement could be reached.

No solution is found for the gas controversy and new price proposals from Gazprom

However, in the midst of this controversy, in the same meeting in Moscow where a solution was being discussed for the "disappeared gas", Gazprom stroke back with worse news: instead of an increase of prices from US\$50tcm to US\$80tcm as had been speculated, Gazprom came up with the figure of

⁶¹ Grivach, "Po puti Rossii", *op. cit.*

⁶² As *Expert* was later to mention, the reasons for this deficit were financial problems from the Ukrainian side (see: Vin'kov and Rubanov, *op. cit.*). *Vremia Novosti* would eventually provide more specifics about this deficit (partially correcting news as reported by Grivach, "Ukraina nashla rossii'skii' gaz", *op. cit.*): 5bcm came from an increase in demand (as had happened the year before, when Ukraine had to buy additional amounts at US\$58tcm) and an additional 5bcm came as a result from the transition to partial payments in cash (see: Grivach, Alexei': "Konets gaza. Iuliia Timoshenko trebuie ot "Naftogaza Ukrainy" srochno dogovoriti'sia s Rossiei' (Конец газа. Юлия Тимошенко требует от "Нафтогаза Украины" срочно договориться с Россией), *Vremia Novosti*, 12 July 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries). As it would be later revealed as a result of attempts from the Ukrainian Ministry of Justice to review a previous agreement from 2004, this deficit seemed to accrue from a reduction in transit payments to make up for debt accumulated from the 90s and owed to Russia.

⁶³ Gavrish and Skorobagatko, *op. cit.*

⁶⁴ Gavrish, Oleg; Butrin, Dmitrii' and Grib, Natal'ia: "Druzhba narodov. "Gazprom" nashel svoi' gaz na Ukraine ("Газпром" нашел свой газ на Украине)", *Kommersant*, 15 June 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries). As explained in this article, it was not clear from which gas reserves Ukraine would be able to make up for this gas.

⁶⁵ Gavrish and Lambaeva, *op. cit.*; Gavrish and Skorobagatko, *op. cit.*; Ivzhenko, Tat'iana: "Viktora Iushchenko poprosili stat' posrednikom. Prezidentu Ukrainy pridetsia lichno razrulivat' gazovyi' konflikt s Rossiei' (Виктора Ющенко попросили стать посредником. Президенту Украины придется лично разруливать газовый конфликт с Россией), *Nezavisimaia Gazeta*, 30 June 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

US\$160tcm.⁶⁶ This was the price resulting from the application of the "netback" principle, as applied to European consumers. In the face of this unexpected offer, Ukraine retaliated threatening with correlative tariff increases (US\$3.5tcm/100km) to make up for higher prices.⁶⁷ With prices at US\$50tcm (*Kommersant* calculated the price Ukraine was paying at the time at around US\$55tcm),⁶⁸ Gazprom's offer was the exact opposite of a progressive price transition. The problem for Ukraine, according to analyses by *Kommersant*, was that neither such an increased tariff for Russian gas would be enough to provide sufficient compensation. Gazprom was not likely to be flexible in this respect: it had in fact officially announced on 7th June that it was about to change its strategy towards former USSR countries and would thus start increasing gas prices towards convergence with market prices as paid by European customers. This would be the case with Baltic countries and as was confirmed by the state company, it might lead to trebled prices for Ukraine, thus confirming price estimations discussed in their bilateral meetings.⁶⁹

The bitter truth for Ukraine was that, as the *Moscow Times* announced, it was caught in a "spiraling gas dispute",⁷⁰ with two fronts open and with scarce prospects of solution; Ukraine had to deal at the same time with changes in the pricing system of Turkmen and Russian gas, and with accusations of corruption, as in the case of undervalued deliveries to the former (see pp. 130-131) and illegal hoarding of Russian gas for the latter.

A new round of negotiations with Russia on 30th June in Moscow⁷¹ was characterized by persisting controversies and a threatening tone from the part of Gazprom: the meetings started with Naftohaz's delegation being told that it had been unilaterally decided that the (no longer) "missing gas"

⁶⁶ Butrin, Dmitrii': "Druzhiba narodov. "Gazprom" predlozhl Ukraine voi'ti v Evropu i platit' za gaz po \$160 za tysiachu kubometrov (Дружба народов. "Газпром" предложил Украине войти в Европу и платить за газ по \$160 за тысячу кубометров)", *Kommersant*, 7 June 2005 (Accessed on 18th August 2011, from East View, Harvard Libraries); "Miller atakoval Ukrainu", *op.cit.*

⁶⁷ Reznik, Irina: "Energoresursy. "Gazprom" torguetsia s Ukrainoi' (Энергоресурсы. "Газпром" торгуется с Украиной)", *Vedomosti*, 8 June 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁶⁸ *Ibid.*

⁶⁹ Aglamishi'an, Varvara: "'Gazprom" uzhestochaet eksport. Na Ukraine nashelsia "propavshii" rossii'skii' gaz ("Газпром" ужесточает экспорт. На Украине нашелся "пропавший" российский газ)", *Izvestiia*, 8 June 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries). Later in July, there came a proposal from the state Duma in this same direction (see: Veletminskii', Igor': "Ekonomika, Gazduma (ЭКОНОМИКА. Газдума)", *Rosii'skaia Gazeta*, 6 July 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries); Averkin, Sergei': "Sosedy. Duma ustroit gazovuiu ataku (Соседи. Дума устроит газовую атаку)", *Tribuna*, 6 July 2005 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

⁷⁰ Combined Reports Bloomberg, MT: "Kiev Caught in Spiraling Gas Dispute", *The Moscow Times*, 23 June 2005 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

⁷¹ "Ukraina budet rasschityvatsia za gaz s Rossiei' tranzitom (Украина будет рассчитываться за газ с Россией транзитом)", *Ukrainskaia Pravda*, 25 June 2005, at <http://www.pravda.com.ua/rus/news/2005/06/25/4389606/> (Accessed on the 18th September 2012).

would be simply deducted as payment for transit tariffs to Ukraine.⁷² In line with such a decision, Gazprom announced that it would supply only 1.1bcm of gas supplies for the rest of the year for transit payments after having applied the discount.⁷³ Naftohaz reacted in kind: insisting on their alternative of returning gas in instalments, Alexei Ivchenko declared that if Russia wanted to proceed as unilaterally decided, Ukraine would apply a different transit tariff which took into consideration the fact of its being planned for export.⁷⁴

Gazprom at the same time insisted on stopping payments in gas for transit tariffs and on selling gas at much more expensive market prices than it had been doing so far. Gazprom was open to discuss additional shipments to make up for any gas deficit, but this would only be considered once market prices were established.⁷⁵ From the Ukrainian side, such proposals and impositions were matched by statements that loomed large in relation to what would eventually happen in January 2006, with for example, Alexandr Gudym, member of the Committee on Energy of the Ukrainian Rada, declaring that undersupplies were not a real issue, as Ukraine in its condition of transit country could "take as much gas as necessary",⁷⁶ thus resurrecting the specter of siphoning off gas so common in the 90s. More disquieting was that Ivchenko went in a similar direction in recent declarations.⁷⁷ In light of these declarations, Sergei Kuprianov, Press-Secretary of Gazprom, made himself clear pointing to the Belarusian example of 2004, when Russia also cut transit supplies to preclude any unsanctioned appropriation of gas.⁷⁸

⁷² "Gazprom" reshil vopros oplaty s Ukrainoi' («Газпром» решил вопрос оплаты с Украиной), *Kommersant*, 28 June 2005, at <http://www.kommersant.ru/news/984494> (Accessed on the 19th September 2012); "Novosti (Новости)", *Nezavisimaia Gazeta*, 29 June 2005 (Accessed on the 22th August 2011, from East View, Harvard Libraries); "Rossiia v odносторонnem poriadke reshila ne dodat' Ukraine 7,8 milliardov kubov gaza (Россия в одностороннем порядке решила не добавить Украине 7,8 миллиардов кубов газа)", *Ukrainskaia Pravda*, 28 June 2005, at <http://www.pravda.com.ua/rus/news/2005/06/28/4389651/> (Accessed on the 19th September 2012); As Sergei Kuprianov, Press-Secretary of the Russian gas monopoly would later add, as a sign of unbending determination from the Russian side: "The Ukrainian side does not have any other alternative than complying" (see: Chereshev, Sergei: "Spor vokrug postavok gaza na Ukrainu ne zakonchen (Спор вокруг поставок газа на Украину не закончен)", *Izvestiia*, 29 June 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

⁷³ Matarykin, Vitaly: "Ukraine asks Gazprom to prevent slashing of nat gas supplies", *Itar-Tass*, 1 July 2005 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁷⁴ "Ivchenko prigrozil "Gazpromu" v otvet na odносторонnee reshenie (Ивченко пригрозил "Газпрому" в ответ на одностороннее решение)", *Ukrainskaia Pravda*, 28 June 2005, at <http://www.pravda.com.ua/rus/news/2005/06/28/4389655/>.

⁷⁵ Gavrish and Skorobagatko, *op. cit.*

⁷⁶ *Ibid.*

⁷⁷ "If from the Russian side they put forward such an account, then we automatically propose to count this gas as Russian export gas through Ukraine in destination to Europe" (see: *Ibid.*)

⁷⁸ For a detailed analysis of this crisis, see: Yafimava, Katja: "Belarus: the domestic gas market and relations with Russia", Chapter 4, in Pirani, Simon at al. (eds.) (2009): *Russian and CIS gas markets and their impact on Europe*, Oxford, Oxford University Press, pp 133-167. At the time, Russia went as far as to cut exports to Europe so as to avoid Belarus siphoning gas off. It was not clear now, though, whether Russia was ready in earnest to go so far (see: "Gazduma", *op. cit.*), as in the case of Ukraine, the volumes involved implied political costs which were much bigger than in the case of Belarus.

6. 3. Ukraine Trapped in the Triangle between Russia and Turkmenistan

In this complex situation, with Ukraine facing unacceptable demands from both Russia and Turkmenistan, Naftohaz needed first to solve the problem of gas deficit. Prime Minister Yulia Tymoshenko took the controversial decision of forbidding the export of any gas before all deficit had been covered and needs of the population had been satisfied.⁷⁹ As explained by *Vremia Novostei*, Ukraine had the authorization since 2002 to re-export 6-5bcm in cooperation with Gazprom and 1bcm freely by Naftohaz itself,⁸⁰ so this decision clearly ran counter to current agreements⁸¹ and would hardly be acceptable for Gazprom.

Coping with the gas deficit in Ukraine and solving the gas controversy

Ivchenko, optimistically declared that Naftohaz's troubles were not so significant (he mentioned only 5bcm of deficit, while he himself had talked about 8bcm before it was already known that 10bcm was the real figure, and that, without taking into account the nearly 8bcm claimed by Gazprom) as he believed he would be able to make up for it with additional exports from Turkmenistan if Gazprom did not offer satisfactory prices for Ukraine.⁸² He stated that Naftohaz was negotiating with independent producers, even if it was not said initially who these producers were⁸³ (Gazprom, whose agreement was necessary if

⁷⁹ Grivach, Alexei': "Novye tseny pugaiut. Iuliia Timoshenko zapretila "Naftogazu Ukrainy" reksportirovat' gaz (Новые цены пугают. Юлия Тимошенко запретила "Нафтогазу Украины" реэкспортировать газ)", *Vremia Novostei*, 30 June 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

⁸⁰ *Ibid.* Gazprom commercialized its share in Poland and Hungary through the intermediary RosUkrEnergo (whose 50 % was owned by Gazprom), while Naftohaz earned around US\$150mill for the 1bcm it sold freely, apart from earnings from the rest sold through Gazprom.

⁸¹ Gavrish, Oleg: "Gazosnabzhenie. Ukraina ostavit sebe rossii'skii' gaz (Газоснабжение. Украина оставит себе российский газ)", *Kommersant*, 30 June 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries). Following declarations from the former Head of Naftogaz, Iurii' Boi'ko, a decision to stop re-export of gas would run counter to existing agreements with foreign customers, whereas the same Alexei' Ivchenko complained about losses incurred by the company if such a measure was made effective. Naftohaz would be allowed to re-export nearly 2bcm she had committed to Rumania and Germany after Tymoshenko was substituted in September 2005 (see: Grivach, Alexei': "'Naftogazu Ukrainy" razreshili eksport ("Нафтогазу Украины" разрешили экспорт)", *Vremia Novostei*, 19 September 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁸² Grivach, "Novye tseny pugaiut", *op. cit.* Similarly optimistic assessments came from Prime Minister Yulia Tymoshenko who stated: "I am convinced that shipments of Turkmen gas will suffice to fully ensure gas supplies for Ukraine": Izhenko, "Viktora Iushchenko poprosili", *op. cit.*

⁸³ "Bez Kommentariiev (БЕЗ КОММЕНТАРИЕВ)", *Vremia Novostei*, 6 July 2005 (Accessed on the 28th August 2011, from East View, Harvard Libraries). It may be possible that Ivchenko's statements were rather directed to Prime Minister Tymoshenko, who went on the offensive against Naftohaz for the failure to secure supplies for Ukraine and who was suspected to be trying to unseat the Head of the state company himself. Finally Ivchenko's post was secured by the President's critical intervention towards the Prime Minister (see: Grivach, Alexei': "'Proshu srochno peresmotret' otnoshenie". Viktor Iushchenko otchital Iuliiu Timoshenko za gazovye ambitsii ("Прошу срочно пересмотреть отношение". Виктор Ющенко отчитал Юлию Тимошенко за газовые амбиции)", *Vremia Novostei*, 7 July 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

these independent producers had to use its facilities, stated it had not been notified).⁸⁴ Naftohaz then provided further details: new shipments amounting to 6bcm⁸⁵ would come from Turkmenistan through a Russian company called "TransNafta",⁸⁶ with RosUkrEnergo also selling an additional volume of 5bcm to close up the gas deficit.⁸⁷ According to Ivchenko, not only would this close up the gap in supplies, but also increase the export capacity of natural gas.⁸⁸ The price apparently agreed with the obscure company was US\$59.5bcm at the Ukrainian border (this did not take into account Russian tariffs which had not been agreed yet).⁸⁹ However, as the daily *Kommersant* acknowledged, Naftohaz had not reached any agreement with Gazprom for these new supplies to be granted access through Russian territory,⁹⁰ and as both this daily and *Vremia Novosti* revealed, this still remained in the realm of declarations of intention.⁹¹ The Prime Minister ordered Ivchenko on 11th July to give a briefing of the situation at the current stage, but this was delayed for alleged technical reasons and at the time of Timoshenko's demands, the Government was left without further details.⁹² A presentation by Ivchenko planned on 27th

⁸⁴ Gavrish, Oleg; Grib, Natal'ia and Ivanov, Petr: "Mezhdunarodnoe sotrudnichestvo. Glava "Naftogaza Ukrainy" nachal otchet (Международное сотрудничество. Глава "Нафтогаза Украины" начал отчет)", *Kommersant*, 6 July 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

⁸⁵ Walters, Greg: "Ukraine Backpedals in Gas Dispute", *The Moscow Times*, 11 July 2005 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁸⁶ As the Head of Naftohaz would soon reveal, thus solving the confusion, the deal was made not with the Russian oil transportation state monopoly "Transneft", whose similarity in name led to confusion (see: "Spasat' Ukrainu ot gazovogo krizisa budet...investor farforovykh servizov (Спасать Украину от газового кризиса будет...инвестор фарфоровых сервисов)", *Ukrainskaia Pravda*, 11 July 2005, at <http://www.pravda.com.ua/rus/news/2005/07/11/4390095/> (Accessed on the 27th September 2012)).

⁸⁷ "Ivchenko dogovorilsia s rossiianami o gaze. No oni ob estom ne znaiut? (Ивченко договорился с россиянами о газе. Но они об этом не знают?)", *Ukrainskaia Pravda*, 11 July 2005, at <http://www.pravda.com.ua/rus/news/2005/07/11/4390072/> (Accessed on the 27th September 2012); Grib, Natal'ia and Gavrish, Oleg: "Druzhba narodov. Ukraina sbalansirovala postavki gaza. "Gazpromu" ob etom neizvestno (Дружба народов. Украина сбалансировала поставки газа. "Газпрому" об этом неизвестно)", *Kommersant*, 12 July 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries); Shevel'kova, Oksana: "Protivogaz. Ukraina nashla 11 mlrd. kubometrov gaza (ПРОТИВОГАЗ. УКРАИНА НАШЛА 11 МЛРД. КУБОМЕТРОВ ГАЗА)", *Gazeta*, 12 July 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

⁸⁸ *Ibid.*

⁸⁹ "Spasat' Ukrainu", *op. cit.* However, news from *Vremia Novosti* suggested that prices from "Transnafta" would rather range around the level of \$90-110bcm (see: Grivach, "Konets gaza", *op. cit.*) and those coming from *Vedomosti*, relying on declarations by a representative from "TransNafta", pointed to an even higher price around US\$150bcm (Reznik, Irina: "Industriia/ Energoresursy. "Trans-Nafta" pomozhet "Gazpromu" (Индустрия/ Энергоресурсы. "Транс-Нафта" поможет "Газпрому")", *Vedomosti*, 12 July 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries)). As for negotiations with RosUkrEnergo, it was told that RosUkrEnergo insisted on a price around US\$100bcm, whereas Naftohaz tried to reach an agreement on the figure of US\$60bcm (see: Grib, Natal'ia, Gavrish, Oleg: "Druzhba narodov. "Naftogaz Ukrainy" kupil gaz zadeshevo. V ministerstve e'konomiki emu ne veriat (Дружба народов. "Нафтогаз Украины" купил газ задешево. В министерстве экономики ему не верят)", *Kommersant*, 13 July 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries)).

⁹⁰ Grib and Gavrish, "Druzhba narodov. Ukraina sbalansirovala", *op. cit.*

⁹¹ *Ibid.* and Grivach, "Konets gaza", *op. cit.*

⁹² Grivach, Alexei: "Neulovimyi' gaz (Неуловимый газ)", *Vremia Novosti*, 27 July 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

July, had to be postponed again when Naftohaz's Head went "on holiday" for two weeks.⁹³ Nothing would eventually come out of these plans.

Agreement on the "missing" gas

The only realistic way to at least not worsen existing relations, which was to solve the dispute between Naftohaz and Gazprom regarding the "missing" gas, came closer,⁹⁴ when the two parts managed to come up with a complex scheme, revealed on 17th July. Naftohaz's version was the following: from the whole volume of 7.8bcm, 2.55bcm would be counted as part of the payment for transit tariffs as Gazprom had been insisting, so Ukraine would receive in the second semester a total of 6.35bcm instead of a meager 1.1bcm in concept of transit tariff. Besides that, the rest (5.25bcm) would be traded by RosUkrEnergo, who would thus pay Gazprom around US\$800mill (which meant the gas would be priced at more than US\$150bcm, with Gazprom recovering most of the losses).⁹⁵ Last but not least, Gazprom also agreed to increase the volumes of natural gas to be exported through Ukraine: for the remainder of the year, Gazprom would increase these volumes by 8bcm (and to 11bcm in 2006), from which there would accrue to Ukraine more gas in payment of transit.⁹⁶

⁹³ Grivach, Alexei: "Avtonomnyi 'Naftogaz'. Iuliia Timoshenko ne mozhет povliiat' na Alekseia Ivchenko (Автономный 'Нафтогаз'. Юлия Тимошенко не может повлиять на Алексея Ивченко)", *Vremia Novostei*, 28 July 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries). As Prime Minister Timoshenko herself acknowledged, the power to name the Head of Naftohaz lay in the hands of the Presidential office.

⁹⁴ Grib, Natalia and Gavrish, Oleg: "Druzhba narodov. 'Gazprom' obvinili v bezotvetstvennom khranении (Дружба народов. 'Газпром' обвинили в безответственном хранении)", *Kommersant*, 7 July 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries); Shevel'kova, Oksana: "Goluboi' potok. 'Gazprom' zadolzhал Ukraine za khranenie gaza (Голубой поток. 'Газпром' задолжал Украине за хранение газа)", *Gazeta*, 7 July 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries). A new and short-lived controversy arose when the energy customs office, which had recently found the location of the "missing" gas, accused Gazprom of not having paid Ukraine for the storage services provided. Gazprom simply replied that, according to the agreed contract, the payment would proceed only upon supply, something which, as we know, had not occurred.

⁹⁵ Actually, the scheme was somewhat more complicated: as a first step, RosUkrEnergo would pay Gazprom US\$800mill for the rights to the amount of 5.25bcm; the second step would come when RosUkrEnergo would resell to "GazpromExport" (export subsidiary of Gazprom) the gas (price unknown). The volumes would then be exported to customers in Europe for a suspected price of US\$1 mill. (see: Rubanov, Ivan: "Russkii' Biznes. Torgovlia gazom. Ot nenavisti do liubvi – odin posrednik (Русский бизнес. Торговля газом. От ненависти до любви – один посредник)", *Expert*, 25 July 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries); Reznik, Irina: "Industriia / Energoresursy. RosUkrEnergo pomozhet 'Gazpromu' (Индустрия / Энергоресурсы. RosUkrEnergo поможет 'Газпрому')", *Vedomosti*, 19 July 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries). It remained unknown to whom the difference of US\$200 would go, but it was possible that the final destination thereof would be RosUkrEnergo for its services of intermediation.

⁹⁶ Grib, Natal'ia; Lambaeva, Renata and Skorobagatko, Denis: "Druzhba narodov. 'Gazprom' podelisia s Ukrainoi' po-materinski. Za propavshii' gaz s kontsernom rasplatitsia ego docherniaia kompaniia (Дружба народов. 'Газпром' поделился с Украиной по-матерински. За пропавший газ с концерном расплатится его дочерняя компания)", *Kommersant*, 18 July 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries); Shevel'kova, Oksana: "Vygodnoe Delo. 'Gazprom' razobratsia so 'styrennym' Gazom (Выгодное дело. 'Газпром' разобрался со 'стыренным' газом)", *Gazeta*, 18 July 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries); "Khronika (ХРОНИКА)", *Izvestiia*, 18 July 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries); Gordeev, Andrei: "Po-evropei'ski. Rossiia i Ukraina reshili problemu ischeznuvshego gaza (По-европейски. Россия и Украина решили проблему

Gazprom then contradicted some of the statements made by its counterpart: the core of the agreement was confirmed, but there were disagreements concerning the gas that Gazprom would export through Ukraine: it was made clear that this had nothing to do with the agreement to solve the issue of the "missing" gas and while it was being stated that Gazprom had no intention to supply any additional amount of gas into Ukrainian storage facilities during the current year, Gazprom informed that the additional gas to transit Ukraine would eventually cover 2bcm for Ukraine in concept of payments for transit (Not far after all from the 2.55bcm discounted, as agreed).⁹⁷

Solving the gas deficit

After this thorny issue seemed to have been finally solved, Ukraine still had to find a way to solve the structural gas deficit and the Ukrainian Ministry of Justice, led by Minister Roman Zvarych, decided (at the behest, as he himself declared, of the Prime Minister herself) to simply nullify the deal reached the preceding year, which as stated above (see p. 136), had put an end to the problem of gas debts to Gazprom inherited from the decade of the 90s:⁹⁸ under the said deal, Ukraine pledged to return Russia a sum of US\$1.62bill over the period of 2005-2009 for a debt that corresponded to the period 1997-2000. The solution was to establish a discount on the transit tariffs that Russia had to pay Ukraine.⁹⁹ As a result, and as the reader may remember, for the above mentioned period, Ukraine would receive 23bcm of gas every year as payment for transit instead of the 28bcm it would have received under normal circumstances, resulting this in a deficit of 5bcm. Instead, an alternative agreement was proposed:

исчезнувшего газа), *Vremia Novostei*’, 18 July 2005 (Accessed on the 23th August 2011, from East View, Harvard Libraries); Mukhtarova, Marina: "Gazavuiu "ataku" otmenili ("ГАЗОВУЮ АТАКУ" ОТМЕНИЛИ)", *Trud*, 19 July 2005 (Accessed on the 27th August 2011, from East View, Harvard Libraries); Reznik, "RosUkrEnergo pomozhet", *op. cit.*; Rubanov: "Ot nenavisti do lyubvi", *op. cit.*; Chereshev, Sergei: "Ukraina vernet gaz "Gazpromu" (Украина вернет газ "Газпрому)", *Izvestiia*, 19 July 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries); "Gazprom, Naftogaz Ukrainy settle gas problem", *Itar-Tass Weekly News*, 17 July 2005 (Accessed on the 27th August 2011, from East View, Harvard Libraries); see also: IEA (2006): "Ukraine: Energy Policy Review", p. 213 at <http://www.iea.org/publications/freepublications/publication/ukraine2006.pdf> (Accessed on the 10th February 2014).

⁹⁷ Gavshina, Oksana: "Sgovora ne bylo. Antimonopol'nyi komitet Ukrainy zakryl delo protiv rossiiskikh neftianikov, a "Gazprom" i "Naftogaz" prodolzhauiut oprovergat' drug druga (Сговора не было. Антимонопольный комитет Украины закрыл дело против российских нефтяников, а "Газпром" и "Нафтогаз" продолжают опровергать друг друга)", *Nezavisimaia Gazeta*, 20 July 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁹⁸ Ukraine initially wanted to transfer the debt during the period of 2003-2013 through Eurobonds, something Russian finally came to reject, as from US\$1.43 billion, US\$630 million would be lost on taxes (see: Shevel'kova, Oksana: "Goluboi' potok. Ocherednaia gazovaia ataka (ГОЛУБОЙ ПОТОК. ОЧЕРЕДНАЯ ГАЗОВАЯ АТАКА)", *Gazeta*, 21 July 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

⁹⁹ Grivach, Alexei: "Dolg ministra iustitsii. Ukraina khochet peresmotret' skhemu pogasheniia starykh dolgov "Gazpromu" (Долг министра юстиции. Украина хочет пересмотреть схему погашения старых долгов "Газпрому)", *Vremia Novostei*’, 21 July 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries); Gavrish, Oleg and Grib, Natal'ia: "Druzhba narodov. Gazpromakh (Дружба народов. Газпромах)", *Kommersant*, 21 July 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

Ukraine would return US\$1.43bill (The sum agreed minus a penalty of US\$190mill)¹⁰⁰ through a credit taken from "Deutsche Bank".¹⁰¹ At the same time, Ukraine wanted to make Gazprom pledge to pump through Ukraine increased volumes of gas, so the latter would at least partially compensate for the resulting deficit through the correlative increase of payments for export tariffs,¹⁰² (this followed the philosophy of the agreement reached for solving the issue of the "missing gas").

However, it seems the final solution for the structural gas deficit would come from additional imports from Central Asia. Ukraine had already imported in the first semester of 2005 1bcm of gas from Uzbekistan, 2.8bcm from Turkmenistan and 2bcm from Kazakhstan in addition to the regular volumes contracted; Uzbek and Turkmen gas was imported through RosUkrEnergo, while Kazakh gas was allegedly contracted through a joint venture between Gazprom and "KazMunaiGaz", "KazRosGaz".¹⁰³ In the following months, the issue receded back into oblivion. This may be a sign that the issue was solved indeed, through additional supplies; Alexei' Ivchenko, in fact, declared having signed an agreement to increase in 1bcm the energy supply from Turkmenistan for the fourth trimester of 2005.¹⁰⁴

Negotiations between Ukraine and Russia regarding prices for 2006

As for negotiations with Gazprom, their weakness lay in the fact that the Prime Minister followed her own strategy while Naftohaz, disconnected from her initiatives, was under the control of Viktor Yushchenko.¹⁰⁵ The question remained whether Timoshenko prohibited gas reexport as an element to confront Gazprom in negotiations (as the Prime Minister herself declared when interviewed by the daily *Kommersant*, one of her goals was to revise the 2004 agreements),¹⁰⁶ or whether this move was aimed rather against Ivchenko himself, who had not satisfactorily delivered regarding the deals sought with both "TransNafta" and RosUkrEnergo. Declarations from the Minister of Justice hinted that RosUkrEnergo

¹⁰⁰ See: Gavshina, Oksana: "Gaz zamuchil. Ukraina gotova sudit'sia s "Gazpromom" po povodu uregulirovaniia zadolzhennosti na 1,6 milliarda dollarov (Газ замучил. Украина готовасудиться с "Газпромом" по поводу урегулирования задолженности на 1,6 миллиарда долларов), *Nezavisimaia Gazeta*, 21 July 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries); Vysova, Kubok: Igroki. Igroki (Игроки. Игроки)", *Kommersant*, 25 July 2005 (Accessed on 26 August 2011, from East View, Harvard Libraries).

¹⁰¹ Gavrish and Grib, "Gazpromakh", *op. cit.*

¹⁰² Grivach, "Dolg ministra iustitsii", *op. cit.* The gas deficit was supposed to be fully closed thanks to supplies from Central Asia through the intermediation of RosUkrEnergo (see: Shevel'kova: "Ocherednaia gazovaia", *op. cit.*).

¹⁰³ Grivach, Alexei': "Kompromissa ne poluchaetsia. "Gazprom" i "Naftogaz" пока не могут договорит'sia ob usloviakh tranzita rossiiskogo gaza (Компромисса не получается. "Газпром" и "Нафтогаз" пока не могут договориться об условиях транзита российского газа)", *Vremia Novostei*, 31 August 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

¹⁰⁴ "Vkrattse (ВКРАТЦЕ)", *Gazeta*, 7 September 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

¹⁰⁵ Gavrish and Grib, "Gazpromakh", *op. cit.*

¹⁰⁶ "Pervye litsa. Iuliia Timoshenko: vlast' na Ukraine okazhetsia v rukakh trekh-chetyrekh chelovek (Первые лица. Юлия Тимошенко: власть на Украине окажется в руках трех-четырех человек)", *Kommersant*, 10 August 2005 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

could have been the target,¹⁰⁷ as the obscure RosUkrEnergo was a creature from the previous administration and which many reproached for its costs and uselessness.¹⁰⁸ In any case, the Prime Minister set up a working group that tried to either exclude RosUkrEnergo outright or at least play down its role, with Roman Zvarych and Ivan Plachkov given preeminence over the state monopoly.¹⁰⁹

In the upcoming negotiations with Gazprom set for mid-August to discuss a pricing agreement for 2006, most responsibility was assumed by Timoshenko's team. Her working group would also try to review the agreement of August 2004 and find a solution for closing the gas deficit, thus fully bypassing Naftohaz.¹¹⁰ Gazprom, which through its Vice-President Alexandr Riazanov, had already expressed a total opposition to any revision of the 2004 debt agreement,¹¹¹ stayed firm and made clear again that it had already laid down the terms for a suitable agreement for 2006.¹¹² Thus, Ukraine's pretensions to review existing agreements and discuss a suitable pricing agreement for a period beyond 2006 were rejected.¹¹³ In spite of both sides digging in, in the meeting between Ivan Plachkov and his Russian counterpart Viktor Khristenko, the Ukrainian Minister of Energy, acknowledged the necessity to work out a formula for a transition to European prices, which sounded like a beginning of concessions to Russia.¹¹⁴

Time however was not ripe yet for compromise: at a meeting between experts from both state monopolies in late August, positions remained in a deadlock. Gazprom insisted on imposing European prices from January 2006 and the Ukrainian delegation expressed its feeling that the only chances for a breakthrough could happen at a presidential summit. From the Ukrainian side, there was a clear feeling of pessimism regarding the fact that whatever satisfactory agreement might be reached, it would only

¹⁰⁷ "Contracts provide for a very strange mechanism, where the debt is repaid from fees for gas transit, but some of this gas goes to a third party - in this case RosUkrEnergo" (see: Shevel'kova, "Ocherednaia gazovaia", *op. cit.*) It must however be acknowledged that The Ministers' explanation, pointing to the different modes of payment for gas imports, gas exports and gas transit, did not seem to have much relation with RosUkrEnergo's role as intermediary. Declarations from "Gazprom" in fact highlighted this (see: *Ibid.*).

¹⁰⁸ An article by the Russian weekly *Profil* also delved into the hypothetical political reasons for Timoshenko's combativeness, pointing to the looming parliamentary elections due for next year (see: Fokina, Ekaterina: "Tekushchii moment. Na dva fronta (Текущий момент. На два фронта)", *Profil*, 15 August 2005 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

¹⁰⁹ "Gazovyi spetsnaz. Kiev mozhет vnov' podniat' vopros o peresmotre soglashenii' s "Gazpromom" ob uregulirovanii v 2004 godu zadolzhennosti za goluboe toplivo (Газовый спецназ. Киев может вновь поднять вопрос о пересмотре соглашений с "Газпромом" об урегулировании в 2004 году задолженности за голубое топливо), *Nezavisimaia Gazeta*, 5 August 2005 (Accessed on the 18th August 2011, from EastView, Harvard Libraries).

¹¹⁰ Grivach, Alexei': "'Otdel'nye ugovovnye skhemy". Ministr iustitsii Ukrainy gotovitsia k gazovym peregovoram s Rossiei' ("Отдельные уголовные схемы". Министр юстиции Украины готовится к газовым переговорам с Россией)", *Vremia Novosti*, 17 August 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

¹¹¹ Gavrish and Grib, "Gazpromakh", *op. cit.*

¹¹² "Gazprom to increase Russian gas transit volume via Ukraine", *Itar-Tass*, 23 August 2005 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

¹¹³ Rybal'chenko, Irina: "Druzhba narodov. Rossiia slomila Ukrainu (Дружба народов. Россия сломила Украину)", *Kommersant*, 23 August 2005 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

¹¹⁴ *Ibid.*

concern the year 2006, with progressive market prices probably kicking in from at least 2007 in the best of cases.¹¹⁵ A visit to Kiev by Alexandr Riazanov on 31st August only brought worse omens for Ukraine, with the high ranking official talking of US\$180tcm instead of US\$160tcm. That probably reflected the trend of increasing oil prices. In the face of such figures, Naftohaz responded that in such a case, transit fees would spike four times more to make up for losses.¹¹⁶

In declarations by the Ukrainian President, where he criticized the barter system (supporting thus, until a certain degree at least, Gazprom's positions) and made the case for ending the (in)efficiency derived from "gas for free" (referring to the cheap prices paid for barter gas as payment of transit fees), the taboo was broken too (in the previous months this had also been mentioned by the then Vice-Minister Anatolii' Kinakh) of accepting a market transition to end cheap energy prices for the industry.¹¹⁷ This could explain how by mid-November, in the midst of Viktor Khristenko's visit to Ukraine, Naftohaz was taking a more flexible response, proposing to increase the price to US\$80tcm from US\$50tcm (this meant reverting to the agreement that both countries had reached in 1999 and which was modified a year later).¹¹⁸ A slightly greater flexibility was also shown by the Russian side, as this time US\$160tcm was offered instead of the latest figure of US\$180tcm. Neither offer really satisfied either of both sides, and the rest of the meeting was lost to secondary discussions, with Ivan Plachkov demanding to establish in their bilateral negotiations the principle of "transport or pay"¹¹⁹ (Khristenko was only ready to apply this

¹¹⁵ Grivach, "Kompromissa ne poluchaetsia", *op. cit.* This would be close to what apparently Ivan Plachkov had put forward on 22nd August (see: Grib, Natal'ia and Gavrish, Oleg: "Druzha narodov. "Gazprom" ob'iavil "Naftogazu Ukrainy" startovuiu tsenu (Дружба народов. "Газпром" объявил "Нафтогазу Украины" стартовую цену)", *Kommersant*, 1 September 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹¹⁶ Grib and Gavrish, ""Gazprom" ob'iavil", *op. cit.* Namely from US\$1.09tcm/100km to US\$3.5tcm/100km. This indeed, would lead to nullify any advantage for Russia in case of a threefold increase in prices. This was unacceptable for Gazprom, who claimed that no European transit country imposed more than a US\$2tcm/100km (see *Ibid.*). As for Ukraine's margin of action, Anatoli Kinakh, Secretary of Ukraine's National Security and Defense Council two months later in October, would state then that an increase of prices from US\$50tcm to US\$90tcm or even US\$120tcm (still far from the US\$180tcm Russia had proposed) would necessarily "create a shock for ties with Russia"; he was plainly hinting at the impossibility to assume such prices (see: "Gas price hikes to be shock for ties with Russia - Ukraine official", *Itar-Tass*, 26 October 2005 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹¹⁷ Grivach, Alexei': "Prezident skazal "ne igrat'" (Президент сказал "не играть")", *Vremia Novosti*, 11 November 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹¹⁸ According to the agreement prevailing then, Ukraine would pay US\$80tcm for Russian gas received while the fee for Russian gas crossing Ukraine as transit country, would amount to US\$1.75tcm/100 km. When the agreement was changed in 2000, Ukraine started receiving gas for only US\$50tcm while the transit fee was also reduced to US\$1.09tcm/100km (the exact price was 1.09375tcm/100 km).

¹¹⁹ This principle was based on the assumption that Russia would have to determine in beforehand which would be the amount of gas to be transported, and to make a payment independently of whether the chosen amount would actually be transited through Ukraine (Russia had apparently proposed the same system, principle of "ship or pay", for the natural gas supplied.

principle to an amount between 50% to 75% of the whole volume to be transported),¹²⁰ which led to no agreement in that particular aspect either.

If hopes could only be placed on high-level summits, the cancellation of the visit by the Russian Prime Minister, Mr. Fradkov, for 23rd November, was probably a bad sign. The apparent reason for the delay, according to the Ukrainian daily *Zerkalo Nedeli*, was that one day prior to his arrival, the Ukrainian Prime Minister was forwarded a proposal to be signed upon his counterpart's visit. Not having enough time to thoroughly consider the proposal and not being thus able to provide a definitive answer, the Russian delegation preferred to agree with their Ukrainian counterparts a postponement to the next month of December. Meanwhile positions kept moving, if timidly:¹²¹

Ukraine was trying to make Russia accept that whatever new prices were agreed, they did not enter into force on the 1st January 2006 but later in March or April. Ukraine, meanwhile, kept to its recent proposal of US\$80tcm.¹²² According to Ivchenko, the working group at the Cabinet of Ministers was preparing for the Russian negotiators a proposal that would imply a cost for Ukraine of US\$1mill to US\$1.5mill, within a scheme of barter. That stood in radical contradiction with what Russia was aiming at, namely price increases that would force Ukraine to foot a bill of US\$4bill (three times more) per year

¹²⁰ Grib, Natal'ia and Gavrish, Oleg: "Druzhba narodov. Viktor Khristenko ne sdal pozitsii 'Gazproma' (Виктор Христенко не сдал позиций 'Газпрома')", *Kommersant*, 15 November 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries); Grivach, Alexei': "Peregovornyi' zastoi' (Переговорный застой)", *Vremia Novostei'*, 15 November 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries); Eremenko, Alla: "Kakoi' budet formula rascheta za tranzit rosiiskogo gaza – tak poika i neizvestno (Какой будет формула расчета за транзит российского газа — так пока и неизвестно)", *Zerkalo Nedeli*, 19 November 2005, at http://zn.ua/POLITICS/kakoy_budet_formula_rascheta_za_tranzit_rossiyskogo_gaza__tak_poka_i_neizvestno-45181.html (Accessed on the 7th October 2012).

¹²¹ Eremenko, Alla: "Pochemu ne podpisani 'gazovyi' protokol mezhdu Ukrainoi' i Rosiiei' (Почему неподписан «газовый» протокол между Украиной и Россией)", *Zerkalo Nedeli*, 26 November 2005, at http://zn.ua/ARCHIVE/pochemu_ne_podpisan_gazovyy_protokol_mezhdu_ukrainoy_i_rossiiey-45243.html (Accessed on the 8th October 2012). The article by Alla Eremenko in *Zerkalo Nedeli* offered details as to what the Russian proposal consisted of: the Russian side had apparently offered to keep prices and transit fees at the same level and start increasing both in 2007, but somehow decreasing the volumes of gas supplied, which would then amount to a "de facto" increase of prices of 25%. This could happen only if Russia drastically decreased its exports of natural gas to Europe, thus running radically counter to the trend of the moment. This proposal, stemming from a source in Naftohaz, was not confirmed and stood in full contradiction with what Russia had been demanding and would eventually keep demanding until the gas crisis in January 2006. Another version was relayed by *Vremia Novostei'* which also pointed to a discount offered by Russia: Barter schemes would be reduced, whereas Ukraine would enjoy a discount for gas (a price close to what Ukraine was paying now) meant for the population and public utilities, whereas remaining volumes would be paid at market prices from "GazpromExport" and RosUkrEnergo. Thereafter a progressive transition to market prices would ensue in the next years (see: Grivach, Alexei': "Novogodnee prevrashchenie (Новогоднее превращение)", *Vremia Novostei'*, 28 November 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries). If we follow a version by *Kommersant*, Fradkov's reason for cancelling his trip was the refusal of a proposal where the new price was the "usual" US\$160tcm (see: Netreba, Petr and Solov'ev, Alexandr: "Politika knuta i kranika (Политика кнута и краника)", *Kommersant*, 19 December 2005 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

¹²² Litvinov, Andrei': "Polumirovyie tseny na gaz (ПОЛУМИРОВЫЕ ЦЕНЫ НА ГАЗ)", *Gazeta*, 21 November 2005 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

and only (partly) compensated if unrealistic transit tariff increases that would earn US\$3bill were applied. Otherwise, Ukraine would have to choose either to become indebted or worse, to reduce the volumes of natural gas imported.¹²³

Russia's adamant position of carrying through a transition to market prices for most of the CIS states and thus revert the trend of years-long subsidization,¹²⁴ made the margin available to Ukraine quite narrow: Gazprom foresaw a price increase of US\$110tcm for Caucasian Republics, something between that same price and US\$160tcm for Moldavia, to be determined yet¹²⁵ and an increase for the Baltic Republics too, from US\$80tcm-US\$95tcm to US\$120tcm-US\$125tcm.¹²⁶ The only "privileged" country to keep advantageous conditions was Belarus, which would be paying US\$46.68tcm. Such a discount did not come for free, as Belarus had to accept a commitment to upgrade the Yamal-Europe pipeline, thus enabling an increase of its throughput to 33bcm¹²⁷ (and reduce dependence on the more worrisome Ukraine) and to open the state company "Beltransgaz" to Gazprom. This was precisely the opposite of Ukraine's course.

While a delegation from Naftohaz was planning to leave for Moscow on 29th November (trip cancelled again), positions moved on, even if only timidly and not enough from bridging the gulf that kept both sides apart: Gazprom offered to establish a transit agreement according to international standards, namely to increase the transit tariffs Russia was paying Ukraine and then to consider a supply agreement separately.¹²⁸ To that, Ukraine agreed in principle as it would probably enjoy better transit tariffs, but Naftohaz nevertheless expressed a preference for keeping the reduced tariff of US\$1.09tcm/100km if that could avert market prices (even though Gazprom allegedly accepted the exorbitant transit tariff of US\$4tcm/100km offered at some point by Ukraine, as a starting point for

¹²³ Vinogradov, Alexandr; Grib, Natal'ia and Zygar, Mikhail: "Navstrechu vyboram. Ukrainskie politiki ishchut gazpodderzhki" (Навстречу выборам. Украинские политики ищут газподдержки), *Kommersant*, 28 November 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

¹²⁴ See: Gamova, Svetlana: "Politicheskaiia truba (ПОЛИТИЧЕСКАЯ ТРУБА)", *Novye Izvestiia*, 7 December 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries), for an account of these changes, including an analysis of Ukraine, and the consideration of political factors too.

¹²⁵ Grivach, "Novogodnee prevrashchenie", *op. cit.*; Alexandr Medvedev later however stated that the price would amount to US\$160tcm, the same as for Ukraine (see: Grivach, Alexei': "Odstupat' nekuda - vpered i Evropa (Отступать некуда - впереди Европа)", *Vremia Novostei'*, 20 November 2005 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

¹²⁶ "Gazprom offers Ukraine higher gas transit price", *Itar-Tass*, 29 November 2005 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹²⁷ Grivach, "Novogodnee prevrashchenie", *op. cit.*; it would be eventually agreed in December that Belarus would pay almost the same price: US\$46,7tcm (See: Gamova, Svetlana: "Tseny ne dlia pressy. Prem'ery Rossii i Ukrainy torgovalis' po gazu bez svidetelei' (ЦЕНЫ НЕ ДЛЯ ПРЕССЫ. ПРЕМЬЕРЫ РОССИИ И УКРАИНЫ ТОРГОВАЛИСЬ ПО ГАЗУ БЕЗ СВИДЕТЕЛЕЙ)", *Novye Izvestiia*, 2 December 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹²⁸ Grivach, Alexei': "Zamorozki v peregovorakh (Заморозки в переговорах)", *Vremia Novostei'*, 29 November 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

discussions).¹²⁹ Gazprom seems to have preferred US\$1.5tcm/100km as a transit tariff,¹³⁰ but no agreement could be reached on that offer either.

Ukraine and Russia were entering December under some of the worst omens. The last rounds of negotiations, as we will see below, would not eventually avoid a gas dispute with the advent of the new year. Meanwhile, as to confirm disquieting hints in the previous months that Ukraine was ready to use Russian gas and divert it for its own use in order to avoid an energy crisis, sources from the European Commission stated that they had received from Naftohaz unofficial information that this could eventually happen in case of "unsettled prices".¹³¹

Pricing negotiations between Ukraine and Turkmenistan

While negotiations with Russia continued, Ukraine kept waging its particular war to maintain both a sustainable and affordable energy balance with Turkmenistan. Ivchenko announced that soon in October, for the occasion of Saparmurat Niyazov's upcoming visit to Kiev, an agreement would be signed thanks to which Turkmenistan was to commit 60bcm every year for a period of 30 years.¹³² This was the second time that such a fantastic project, which stood in clear contradiction to that signed between the reclusive Central Asian Republic and Russia in 2003, was mentioned.¹³³ The agreement to be signed in a month would consider the means of payment (decided on a yearly basis) and the possibility to establish a consortium to build a pipeline system through Turkmenistan, Kazakhstan, Russia and Ukraine for direct export to Europe. It is safe to assume that Ukraine was falling into Ashgabat's trap of trying to exert the best price from competitors, a fight in which the likely loser to a better positioned Russia was inevitably, Ukraine. As the daily *Kommersant* put it: "Turkmenistan was selling its gas twice".¹³⁴

¹²⁹ "Vchera (Вчера)", *Kommersant*, 29 November 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

¹³⁰ "Gazprom offers Ukraine", *op. cit.*

¹³¹ Makarchev, Vitaly: "EU alarmed by Ukraine's threats to reduce transit gas deliveries", *Itar-Tass*, 30 November 2005 (Accessed on 31st August 2011, from East View, Harvard Libraries).

¹³² Grib, Natal'ia; Gavrish, Oleg: "Druzhiba narodov. Turkmeniia prodast gaz dvazhdy (Дружба народов. Туркмения продаст газ дважды)", *Kommersant*, 7 September 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries); "Dvo'inye standarty Turkmenii (Двойные стандарты Туркмении)", *Kommersant*, 12 September 2005 (Accessed on the 4th August 2011, from East View, Harvard Libraries)

¹³³ Gazprom was to become in 2007 the main buyer of Turkmenistan's gas resources, but prospects were extremely unrealistic about gas production in Turkmenistan as to match such figures.

¹³⁴ *Ibid*; In the same unrealistic line, Ukraine exploited its pro-Western line in a new diplomatic move, this time with Poland, with whom Kiev declared to have the intention to sign a common declaration of energy independence from Russia and to pledge their mutual support to both the extension to the Polish city of Plock of the Odessa-Brody oil pipeline and the construction of a new gas pipeline which would connect their gas network to that of Germany and the Czech Republic (see: "Vkrattse", *op. cit.*

The substitution of Yulia Tymoshenko by Iurii' Ekhanurov in October 2005, meant that Yushchenko and Naftohaz (under his control) would be free from interferences from the government. This however, could hardly brighten prospects for Ukraine in negotiations with Gazprom. A proof of the solid position the Russian state monopoly had in Central Asia was the agreement reached with Uzbekistan's "Uztransgaz" for 5 years (2006 to 2010); this agreement ensured Gazprom's monopoly of all gas transiting the Central-Asia pipeline through that country (the transit route for natural gas from Turkmenistan).¹³⁵ Then, when Ukraine tried to establish projects with Turkmenistan, Saparmurat Niyazov bluntly put them face-to-face with the unsolvable dilemma: *"How could we sign it (agreement) without Russia?"*. He cynically expressed his readiness to sign a long-term treaty with Ukraine, as long as it also involved Russia, something natural as gas pipelines would have to cross the country.¹³⁶ Prospects for a trilateral agreement suiting every party were very dim.

Naftohaz could not expect too much from pricing negotiations with Turkmenistan either, in spite of its misplaced optimism of buying as much as 44bcm of Turkmen gas (36bcm directly from "TurkmenNeftegaz" and 8 through the intermediation of GazpromExport).¹³⁷ Ukraine had first to pay the debt that had piled up. Turkmenistan proposed that this would be paid along with the bill due for gas in the second semester, where the price had been set at US\$44tcm, but in any case, "before year's end".¹³⁸ Mr. Ivchenko explained that an agreement had been reached for US\$243mill¹³⁹, while the Prime Minister himself, Iurii' Ekhanurov, talked of an agreement reached for US\$212 mill¹⁴⁰ (slightly different, but nevertheless close to what Ivchenko had declared). Then, Turkmenistan, heralding what Ukraine would soon have to face, started demanding from Gazprom better prices for its natural gas: the specific demand

¹³⁵ Grib, Natal'ia and Gavrish, Oleg: "Druzhba narodov. "Gazprom" vykrutyl Ukraine ventil' (Дружба народов. "Газпром" выкрутил Украине вентиль)", *Kommersant*, 28 September 2005 (Accessed on the 23rd August 2011, from East View, Harvard Libraries); Grivach, Alexei': "Ochen' uzkie mesta. "Gazprom" dogovorilsia s Uzbekistanom o minimal'nom tranzite turkmenskogo gaza (Очень узкие места. "Газпром" договорился с Узбекистаном о минимальном транзите туркменского газа)", *Vremia Novostei*, 28 September 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries); Liuta, Ganna: "Tranzitnye niuansy (Транзитные нюансы)", *Zerkalo Nedeli*, 1 October 2005, at http://zn.ua/ECONOMICS/tranzitnye_nyuansy-44736.html (Accessed on the 4th October 2012).

¹³⁶ "Turkmen leader: future gas exports to Ukraine must be negotiated with Russia", *Kyiv Post*, 13 October 2005, at <http://www.kyivpost.com/content/business/turkmen-leader-future-gas-exports-to-ukraine-must--23336.html?flavour=full> (Accessed on the 4th October 2012).

¹³⁷ Liuta, Ganna: "Iz Ashgabada – s pustymi rukami (Из Ашгабада — с пустыми руками)", *Zerkalo Nedeli*, 15 October 2005, at http://gazeta.zn.ua/ECONOMICS/iz_ashgabada__s_pustymi_rukami.html (Accessed on the 4th October 2005).

¹³⁸ Grib, Natal'ia: "Bor'ba za energonositeli. Turkmeniia poslala Ukrainu v "Gazprom" (Борьба за энергоносители. Туркмения послала Украину в "Газпром", *Kommersant*, 14 October 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹³⁹ Grivach, Alexei': "KONFLIKT. "Vy mnogo govorite, a nichego ne delaete" (КОНФЛИКТ. "Вы много говорите, а ничего не делаете")", *Vremia Novostei*, 14 October 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

¹⁴⁰ Eremenko, Alla: "Kto komu Sheherezada (Кто кому Шехерезада)", *Zerkalo Nedeli*, 22 October 2005, at http://zn.ua/ECONOMICS/kto_komu_sheherezada-44918.html (Accessed on the 6th October 2012).

was to supply gas at US\$50tcm in 2006 and US\$60tcm in 2007.¹⁴¹ An incident provoked by Turkmenistan's not fulfilling its supply commitments, shipping less gas than agreed (Mr. Ivchenko talked of 112tcm received the preceding day instead of the 125tcm foreseen),¹⁴² and possibly related to the still unsolved debt problems, was a prelude of the new price offensive: the Turkmenbashi publicly announced he would enforce a price hike from US\$44tcm to US\$60tcm in 2006 (exactly as on the 1st January 2005) and called its three customers, Russia, Ukraine and Iran, to reach an agreement on prices before 10th December.¹⁴³ Turkmenistan directly challenged Gazprom declaring that the agreement signed in 2003 had not been yet finalized.¹⁴⁴ Neither Gazprom nor Naftohaz accepted Turkmenistan's pretensions and pointed to existing agreements as a guarantee for preserving current and more advantageous conditions.¹⁴⁵

6. 4. Last Negotiations and Failure to Reach an Agreement: Ukraine and Russia Head to Crisis

As the Russian weekly *Tribuna* accurately informed in relation to the latest events and the state of utter confrontation between Russia and Ukraine, the chain of events had been a cancellation of his trip by Prime Minister Fradkov, a subsequent cancellation by Naftohaz's delegation of a trip to Moscow and then warnings from Ivchenko that Russian transit gas might suffer disruptions if prices were increased, to which Gazprom's Alexandr Riazanov reacted saying that such low prices for Ukraine (US\$50tcm) were unacceptable.¹⁴⁶ Ukraine's dilemma was that in the face of a dramatic increase in prices of world oil market (to which gas was pegged) the later Kiev managed to achieve a satisfactory agreement, the higher prices Ukraine would eventually have to assume if it wanted to avoid supply cuts. This danger was made

¹⁴¹ Borisov, Nikolai': "Energoresursy. Turkmeniia khochet povysit' tseny na gaz (Энергоресурсы. Туркмения хочет повысить цены на газ)", *Vedomosti*, 21 October 2005 (Accessed on the 23rd August 2011, from East View, Harvard Libraries); Grivach, Alexei': "Sosedi. Dopлата za uslugu (СОСЕДИ. Доплата за услугу)", *Vremia Novostei'*, 21 October 2004 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

¹⁴² Ivchenko hinted at problems related with Uzbekistan, the first transit country in direction to Ukraine, but placed responsibility on Turkmenistan as a supplier country (see: "Bez Kommentariiev (БЕЗ КОММЕНТАРИЕВ)", *Vremia Novostei'*, 17 November 2005 (Accessed on the 26th August 2011, from East View, Harvard Libraries);

¹⁴³ Kurbanova, Anna: "Niyazov offers Russia, Ukraine, Iran to reach agt on gas purchase", *Itar-Tass*, 19 November 2005 (Accessed on the 31st August 2011, from East View, Harvard Libraries); Grivach, Alexei': "Turkmenskii' retsidiv (Туркменский рецидив)", *Vremia Novostei'*, 21 November 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries); Grib, Natal'ia and Gavrish, Oleg: "Saparmuratu Niazovu gaz vse dorozhe (Международное сотрудничество. Сапармурату Ниязову газ все дороже)", *Kommersant*, 21 November 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

¹⁴⁴ Kurbanova, Anna: "Turkmenistan plans to increase export prices of gas in 2006", *Itar-Tass*, 19 November 2005 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁴⁵ Grib and Gavrish, "Saparmuratu Niazovu", *op. cit.*; Khvesik, Dmitrii': "Tendentsy. Sobytiia. Fakty. Mneniia (ТЕНДЕНЦИИ. СОБЫТИЯ. ФАКТЫ. МНЕНИЯ)", *Gazeta*, 21 November 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries); Matarykin, Vitaly: "Ukraine says no proposals on higher prices for Turkmen gas", *Itar-Tass*, 24 November 2005 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁴⁶ Tell, Rustem: "Igy na trube (ИГРЫ НА ТРУБЕ)", *Tribuna*, 2 December 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

explicit by Alexandr Medvedev, at the time Director General of Gazexport, when he warned of even higher prices.¹⁴⁷

Trying to put an end to the spiral of cancellations, threats and hardening positions, Prime Minister Ekhanurov prepared a trip to Moscow with the goal of reaching a final compromise. Having made its position regarding higher prices more flexible, Ukraine now wanted to secure an agenda of progressive application, something to which Russia could also agree in principle. However, Ukraine was still reluctant to accept prices higher than US\$80tcm and Russia hardly moved from US\$150tcm. With starting positions so apart from each other, any agreement would prove very difficult. That was especially so as the Russian side had already put forward a variant of what had been agreed in Belarus and which could never be accepted by Ukraine: a participation in the Ukrainian gas transportation system (GTS) in exchange for concessions.¹⁴⁸ As if to highlight the window of opportunity that Ukraine might miss if not yielding to alternatives offered so far, Alexandr Medvedev warned that they would soon put forward a new offer, which if refused, would lead to higher prices.¹⁴⁹

Upon Ekhanurov's arrival in Moscow, *Vremia Novosti* optimistically assumed that an agreement would be eventually found, even if negotiations lasted until the very last moment, for the sake of avoiding perturbations in the flow of gas to Europe and protecting common reputation.¹⁵⁰ However, the meeting on 5th December failed miserably: Sergei Kuprianov went as far as to denounce Ukraine's position as unconstructive and dangerous for gas supplies to Europe, while Ukraine insisted on keeping the barter system until as late as 2013, something which Gazprom could not tolerate. In an assessment by *Itar-Tass*, the financial burden for Ukraine of switching both to market prices and cash-based payments would be huge, as the payments might increase as much as US\$3.5bill; Ukraine was expected not to be able to increase payments in concept of transit tariff beyond more than US\$1.5bill.¹⁵¹ In a similar assessment, *Ukrainska Pravda* calculated the costs of new prices to be as high as US\$4bill, and considered that only an increase of transit tariffs to US\$3.5tcm/100 km (as proposed at some point by Naftohaz)¹⁵² could

¹⁴⁷ *Ibid.* : "If the current price is not accepted by Ukraine, "Gazprom" will have to offer a price even higher. The \$160 offered is a compromise price. The fact is that in Europe it goes over \$200".

¹⁴⁸ Gamova, "Tseny ne dlia pressy", *op. cit.*

¹⁴⁹ Eremenko, Alla: "Iazik moi' – vrag moi' (Язык мой — враг мой)", *Zerkalo Nedeli*, 3 December 2005, at http://zn.ua/ECONOMICS/yazyk_moy__vrag_moy-45297.html (Accessed on the 9th October 2012).

¹⁵⁰ Denisov, Andrei': "Ul'timatum sebe (Ультиматум себе), *Vremia Novosti*", 5 December 2005 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

¹⁵¹ "Gazprom announces failure of gas negotiations with Ukraine", *Itar-Tass*, 6 December 2005 (Accessed on the 29th August 2011, from East View, Harvard Libraries). In fact, the budget planned for 2006 in Ukraine did not provide for prices beyond US\$80tcm (see: Gamova, "Politicheskaiia truba", *op. cit.*).

¹⁵² Bondarenko, Dmitrii': "Gazovyi' nerv ukrainsko-rossiiskikh otnoshenii' (Газовый нерв украинско-российских отношений)", *Ukrainskaia Pravda*, 6 December 2005, at

compensate for the impact. According to this daily, Alexei Ivchenko had offered a complex formula by which 17bcm of gas would remain at the price of US\$50tcm, while the remaining 8bcm would be paid at US\$80tcm-US\$82tcm in the first semester and rise to US\$90tcm-US\$96tcm by the end of the year (this latter amount would be ensured through the intermediation of RosUkrEnergo).¹⁵³ That clearly fell short of Gazprom's demands.

The stone on which both negotiators stumbled in this occasion was on their diverging interpretations of a series of previous agreements: Naftohaz defended the sanctity of the June 2002 transit contract¹⁵⁴ and interpreted that it could not be modified before 2013, given its validity of 10 years (Ukraine would later add that all existing agreements also precluded any change in prices until 2009).¹⁵⁵ Gazprom however, pointed to article 2 of the previous intergovernmental agreement signed in October 2001, which gave freedom to both contractors to determine on a yearly basis whether payments for transit would be made in barter or cash and to fix the price, feeling thus fully legitimated to demand new conditions for 2006.¹⁵⁶ The Russian side offered a new formula (probably the offer Alexandr Medvedev had talked about before), which consisted of a double transition, to cash-based payments and to a basis of

<http://www.pravda.com.ua/rus/articles/2005/12/6/4394702/> (Accessed on the 19th December 2012). The article told of a maximum of US\$2tcm that prevailed in the rest of Europe as an obstacle to raising the transit tariff beyond that. According to a report by the Energy Charter of 2006, if the nominal value for a transit tariff of US\$1.09tcm/100km, as in Ukraine, was 28, Austria ranked with 96, as it had the highest transit tariff in Europe (see: "Gas Transit Charges: in selected Energy Charter countries", Energy Charter (January 2006), at

http://www.encharter.org/fileadmin/user_upload/document/Gas_Transit_Tariffs_-_2006_-_ENG.pdf and Pirani, Simon: "Ukraine's Gas Sector", Oxford Institute for Energy Studies (June 2007), pp. 84-85).

¹⁵³ "Ivchenko ne sdaetsia "Gazpromu" i predlagaet emu porytsia v pamiaty (Ивченко не сдается "Газпрому" и предлагает ему порыться в памяти)", *Ukrainskaia Pravda*, 7 December 2005, at

<http://www.pravda.com.ua/rus/news/2005/12/7/4394732/> (Accessed on the 19th October 2012).

¹⁵⁴ In June 2002 Russia and Ukraine signed a 10 year contract within the framework of the October 2001 agreement and due to last from 2003 to 2013 (Yafimava, Katja (2011): *The transit dimension of EU energy security: Russian gas transit across Ukraine, Belarus, and Moldova*, Oxford; New York, Oxford University Press, p. 155).

¹⁵⁵ Veletminskii, Igor' and Chichkin, Aleksei': "Progress poka ne viden (Прогресс пока невиден)", *Rossii'skaia Gazeta*, 9 December 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries); Petrov, Genadii': "Otstavka na golubom Naftogaza (OTSTAVKA NA GOLUBOM GAZU)", *Moskovskii' Komsomolets*, 12 December 2005. (Accessed on the 17th August 2011, from East View, Harvard Libraries); Chai'ka, Fedor: "Ukrainskii' natsionalist poluchil otstavku vmesto gaza (Украинский националист получил отставку вместо газа)", *Izvestiia*, 12 December 2005 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

¹⁵⁶ "Ukrainian unconstructive attitude endangers energy security – Gazprom", *Itar-Tass*, 6 December 2005 (Accessed on 27th August 2011, from East View, Harvard Libraries) and "Kak dogovarivaiutsia "Gazprom" s "Naftogazom" (Как договариваются "Газпром" с "Нафтогазом)", *Kommersant*, 9 December 2005 (Accessed on the 17th August 2011, from East View, Harvard Libraries). The article by Zerkalo Nedeli: Malinovskii', Alexandr; Kurdel'chuk, Danil and Novak, Inna: "Ukraina – Rossiia: evropei'skii' podkhod k resheniiu gazovoi' dilemmy na osnove verkhovenstva prava (Украина—Россия: европейский подход к решению газовой дилеммы на основе верховенства права)", *Zerkalo Nedeli*, 17 December 2005, at http://zn.ua/PRESS_RELEASE/ukrainarossiiia_evropeyskiy_podhod_k_resheniyu_gazovoy_dilemmy_na_osnove_verhovenstva_prava-45446.html?rubric=78 (Accessed on the 16th October 2012), analyses the juridical intricacies of mutual energy relations and the arguments of each of the contenders.

US\$160tcm moderated by an "important discount" not specified.¹⁵⁷ The Ukrainian delegation rejected the offer and Alexander Medvedev, venting his frustration mentioned again the creation of a consortium to manage Ukraine's gas transportation system.¹⁵⁸ Some days later, the Secretary of the National and Defense Council, Anatoly Kinakh, offered his alternative: a gradual price transition with gas prices reaching between US\$95tcm and US\$103tcm in order that chemical and metallurgical industries, key for the Ukrainian economy, could remain profitable.¹⁵⁹

In spite of Yushchenko's optimism at reaching an agreement with his counterpart Vladimir Putin over existing disagreements,¹⁶⁰ the Russian President himself, after having talked to Yushchenko by telephone and having held a personal interview with the Ukrainian Rada's Speaker, Volodymyr Lytvyn, came to the conclusion that Ukraine had enough financial means to offset the impact of the increase of gas prices foreseen for the next year thanks to financial resources obtained from privatizations and credits from international institutes.¹⁶¹ He also pointed out that Ukraine had in fact enough reserves (from its own production) to ensure critical supplies for the population, imported gas being used for the industrial sector.¹⁶² Putin further complained that Gazprom was losing as much as US\$3.6bill based on calculations for gas prices in 2006 for other European countries, which were according to him to reach as much as US\$255tcm in the case of Germany (Putin was already hinting at the price Ukraine might finally have to pay if negotiations for a compromise ended up failing).¹⁶³ That way, he managed to reinforce the message that Russia wanted to convey, namely that whatever offer Gazprom put forward now would be much better than what might come later.

¹⁵⁷ Grib, Natal'ia and Gavrish, Oleg: "'Gazprom' sdelał vygodnoe predlozhenie Ukraine ('Газпром' сделал выгодное предложение Украине)", *Kommersant*, 7 December 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁵⁸ "Kak dogovarivaiutsia", *op. cit.*

¹⁵⁹ Melnik, Mikhail: "Ukraine ready for gradual transfer to monetary gas settlements", *Itar-Tass*, 9 December 2005 (Accessed on the 9th August 2011, from East View, Harvard Libraries); Kashin, Vasilii' and Bekker, Alexandr: "Gaz dolzhen podorozhat' ne srazu (Газ должен подорожать не сразу)", *Vedomosti*, 13 December 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹⁶⁰ Grib and Gavrish, "Gazprom sdelał", *op. cit.*

¹⁶¹ Grivach, "Schet idet", *op. cit.* See also: Kolesnikov, Andrei': "Vladimir Putin rasschital Ukrainu (Владимир Путин рассчитал Украину)", *Kommersant*, 9 December 2005, at <http://kommersant.ru/doc/633921> (Accessed on the 15th October).

¹⁶² Grivach, "Schet idet", *op. cit.* The truth is that imported gas was also needed for the production of electricity and heating (see: *Ibid.*).

¹⁶³ *Ibid.*; Smirnov, Konstantin: "Ukraina ukrala u Rossii pochni piat' milliardov dollarov (УКРАИНА УКРАЛА У РОССИИ ПОЧТИ ПЯТЬ МИЛЛИАРДОВ ДОЛЛАРОВ)", *Gazeta*, 9 December 2005 (Accessed on the 9th August 2011, from East View, Harvard Libraries). Calculations from the daily *Kommersant* (See article before), yielded possible losses for the Russian side amounting to up to US\$4.5bill. However, it must be acknowledged that the price paid by Germany was not the benchmark to which prices for Ukraine could be determined, as transportation costs were arguably higher for a country which like Germany, was much farther away than the latter.

At the same time, the Russian Minister of Energy, Viktor Khristenko, stated that in spite of ongoing negotiations regarding future prices, the volumes of gas to be supplied in 2006 had been agreed, 51bcm. Mr. Khristenko did not go into details as to the breakdown of the said volume, but taking into account that Gazprom had pledged to help the transit of 36bcm of Turkmen gas bought by RosUkrEnerg and that the rest coming from Russia was to amount to 15bcm,¹⁶⁴ this would not close the structural deficit of 5-6bcm Ukraine suffered since the debt arrangement of 2004.

Russia hardens its positions regarding prices: from US\$160tcm to US\$230tcm

Then soon after Putin's new warning, and fed up with Ukraine's uncompromising stance Gazprom fired again: the Russian state monopoly officially announced that Ukraine had lost the opportunity to purchase gas at the relatively advantageous price of US\$160tcm and would therefore have to accept market prices ranging from US\$220tcm to US\$230tcm.¹⁶⁵ With Ukraine refusing to hand over 50% of its infrastructure to the Russian monopoly as part of a possible compromise on the ongoing dispute,¹⁶⁶ the only alternative left was to pay higher prices. Alexei Miller completed the picture with a new warning: Ukraine would see supplies stopped if no contract had been signed by 1st January of the upcoming year; the possibility in Gazprom that Ukraine would respond "by stealing" gas from supplies going to other European customers was considered seriously enough to constitute an operational group to oversee such an eventuality.¹⁶⁷ If this new turn for the worse was not enough, Ukraine was dealt a new blow when Turkmenistan maintained its insistence on gas prices of US\$60tcm.¹⁶⁸ One week later, a Ukrainian delegation led by the Minister of Energy Ivan Plachkov and the Head of Naftohaz, Alexei Ivchenko, hastily flew to Ashgabat to avert the price hike and a double crisis with both Russia and Turkmenistan;¹⁶⁹ the stakes were high, with Turkmenistan having supplied 36bcm in 2005 and covered 45 % of Ukraine's needs (Ukraine

¹⁶⁴ This calculation might have implicitly taken into account the new prices Russia was offering, and which would automatically yield less gas in payment of transit fees.

¹⁶⁵ More than the US\$180tcm that at some point before, Gazprom had threatened with in case of non-acceptance of the US\$160tcm initially offered (See: "'Gazprom' zapugivaet eshche bol'shei' tsenoi' ('Газпром' запугивает еще большей ценой)", *Ukrainskaia Pravda*, 8 December 2005, at <http://www.pravda.com.ua/rus/news/2005/12/8/4394760/> (Accessed on the 19th October 2012).

¹⁶⁶ Grib, Natal'ia and Gavrish, Oleg: "'Gazprom' otsenil otkaz Ukrainy ('Газпром' оценил отказ Украины)", *Kommersant*, 15 December 2005 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

¹⁶⁷ Sergeev, Mikhail: "Ukrainu postavili na schetchik (УКРАИНУ ПОСТАВИЛИ НА СЧЕТЧИК)", *Gazeta*, 15 December 2005 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

¹⁶⁸ "Turkmeniia povysit tsenu na gaz dlia Ukrainy (Туркмения повысит цену на газ для Украины)", *Kommersant*, 15 December 2005, at <http://www.kommersant.ru/news/988167> (Accessed on the 15th October 2012).

¹⁶⁹ Melnik, Mikhail: "Ukraine officials go to Ashgabat to discuss gas supplies", *Itar-Tass*, 22 December 2005 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

expected to import 39bcm in 2006).¹⁷⁰ Unfortunately for Ukraine, nothing could change Ashgabat's position.

On 15th December Iurii´ Ekhanurov and the Minister of Energy Ivan Plachkov met with Gazprom´s delegation, but could hardly convince their counterparts to create a new trader by Naftohaz and Gazprom as parity stakeholders which would assume the import of both Russian and Turkmen gas (this would in fact turn such a company into the monopolist of Ukrainian gas imports). More importantly, neither could they agree on a calendar of progressive transition to market prices from 2006 to 2009.¹⁷¹ Russia, firm in its intention of imposing a price transition to market conditions, would only offer Ukraine credit facilities in order to absorb the impact of the new prices.¹⁷² In the face of the Russian negative, Ukraine resorted again to threats. On this occasion, they threatened to change the conditions under which the Russian fleet in the Black Sea was based in the Crimean city of Sebastopol.¹⁷³ President Yushchenko himself was to make an explicit threat some days later in the same direction, pointing to possible increases in payments by Russia if it wanted to maintain its rights in the base of Sebastopol.¹⁷⁴ Declarations by Alexandr Medvedev to Ukrainian journalists made clear that Gazprom was seriously considering the worst scenario and that consequences for Ukraine would not be pleasant: *"I would not like to present a too tragic scenario, the reason being that even if that was to happen, we ("Gazprom". - ed.) would supply "Naftohaz of Ukraine" gas in accordance with our international obligations - to the extent necessary to meet the needs of European consumers (emphasis mine). Absence of a contract for the supply of gas to Ukraine would mean that gas for the needs of Ukraine will not come (emphasis mine). And if Ukraine illegally siphoned off gas, in other words- stole it, then Ukraine would be fully responsible for the reduction of gas supplies to Europe (emphasis mine)"*.¹⁷⁵

¹⁷⁰ *Ibid.*; Rzhnevsky, Valery: "Ukraine puts off decision on gas prices until talks in Ashgabat", *Itar-Tass*, 22 December 2005 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁷¹ Grivach, Alexei´: "Obmen liubeznostiami (Обмен любезностями)", *Vremia Novostei´*, 16 December 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries). See also: Liuta, Ganna: "Ne stol´ ubiditel´ny, skol´ gromki zaiavleniia "Gazproma" (Не столь убедительны, сколь громки заявления «Газпрома»)", *Zerkalo Nedeli*, 17 December 2005, at

http://zn.ua/ECONOMICS/ne_stol_ubeditelny,_skol_gromki_zayavleniya_gazproma-45426.html (Accessed on the 16th October 2012).

¹⁷² Veletninskii, Igor´; Kukol´, Elena and Chichkin, Alexei´: "Ukraina ishchet vykhod (Украина ищет выход)", *Rossii´skaia Gazeta*, 16 December 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹⁷³ Sergeeva, Iana: "Deshevaia Myshelovka (ДЕШЕВАЯ МЫШЕЛОВКА)", *Novye Izvestiia*, 16 December 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

¹⁷⁴ Chai´ka, Fedor: "Viktor Iushchenko poshel v gazovuiu ataku. Sredi argumentov - Chernomorskii´ flot i Stokgol´mskii´ sud (Виктор Ющенко пошел в газовую атаку. Среди аргументов - Черноморский флот и Стокгольмский суд)", *Izvestiia*, 21 December 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹⁷⁵ Liuta, "Ne stol´ ubiditel´ny", *op. cit.*

A new round of negotiations between both Prime Ministers, Iurii' Ekhanurov and Mikhail Fradkov taking place on 19th December in Moscow was equally disappointing: Ekhanurov insisted on a progressive transition to market prices to no avail¹⁷⁶ (Viktor Yushchenko reinforced the message advocating for a period of 2-3 years)¹⁷⁷. According to the daily *Vedomosti*, Naftohaz had been handed over a proposal for a transit contract (no details transpired) when only 10 days were left before New Year.¹⁷⁸ Meanwhile, just before the visit by Ekhanurov to Moscow on 19th December, the Belarusian Prime Minister Sergei Sidorskii' had signed the agreement whereby Belarus would enjoy a price similar to what Ukraine was now enjoying, US\$46.68tcm, obtained in exchange of 50% of the state monopoly "Beltransgaz" for Gazprom.¹⁷⁹ The former Head of Naftohaz, Iurii' Boi'ko went in the same direction when he wrote in *Vedomosti* recommending the creation of a transportation consortium in the line of what had been agreed in 2004.¹⁸⁰ Any option in this direction remained unacceptable for Ukraine. Following threats to review conditions for the Russian fleet based in Sebastopol¹⁸¹ Gazprom was now warned that it would be sued before the Arbitrage Tribunal of Stockholm. At the same time the approbation of a New Concept of Energy Security by the Ukrainian Council of Security and Defense was made public, where much emphasis was put on the rationalization of the use of energy through an increased use for the home industry of Ukraine's own production and the use of other sources such as coal and nuclear energy.¹⁸²

As for price negotiations, The Ukrainians spoke of US\$65tcm, supposed to be the median price of Russian gas paid by Ukraine in the past decade,¹⁸³ while the Minister of Economics pointed to prices ranging from US\$100tcm to US\$150tcm as discriminatory for Ukraine.¹⁸⁴ The set of proposals Gazprom

¹⁷⁶ Rzhnevsky, Valery: "Ukraine ready to pay for Russian gas at market prices – PM", *Itar-Tass*, 19 December 2005 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁷⁷ Bekker, Alexandr: "Zria priekhal (Зря приехал)", *Vedomosti*, 20 December 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁷⁸ *Ibid.*

¹⁷⁹ Netreba, Petr and Grib, Natal'ia: "Snizhennyi' prirodnyi' gaz (Сниженный природный газ)", *Kommersant*, 20 December 2005 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

¹⁸⁰ Boi'ko, Iurii': "Ukraina - Rossiia: Piat' shagov k vykhodu (Украина - Россия: Пять шагов к выходу)", *Vedomosti*, 20 December 2005 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

¹⁸¹ Sidorenko, Sergei'; Solov'ev, Vladimir and Grib, Natal'ia: "Ukraina grozit "Gazpromu" Stokgol'mskim sudom i sudami Chernomorskogo flota (Украина грозит "Газпрому" Стокгольмским судом и судами Черноморского флота)", *Kommersant*, 21 December 2005 (Accessed on the 23rd August 2011, from East View, Harvard Libraries); Stepanenko, Svetlana and Grivach, Alexei: "Za gaz otvetit Chernomorskii' flot (За газ ответит Черноморский флот)", *Vremia Novostei'*, 21 December 2005 (Accessed on the 26th August 2011, from East View, Harvard Libraries); Matarykin, Vitaly: "Yekhanurov orders drafting appeal to Stockholm Court", *Itar-Tass*, 23 December 2005 (Accessed on the 30th August 2011, from East View, Harvard Libraries); Chai'ka, "Viktor Iushchenko poshel", *op. cit.*

¹⁸² Sidorenko, Solov'ev and Grib, *op. cit.*; Stepanenko and Grivach, *op. cit.*

¹⁸³ Matarykin, Vitaly: "Ukraine suggests basic gas price of \$65 per 1,000 – minister", *Itar-Tass*, 23 December 2005 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

¹⁸⁴ Rzhnevsky, Valery: "Social democrats leader urges government to resign", *Itar-Tass*, 24 December 2005 (Accessed on the 30th August 2011, from East View, Harvard Libraries); "Russia's Gazprom adamant to end gas supplies to Ukraine if no deal", *Itar-Tass*, 26 December 2005 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

had handed over to Naftohaz in Moscow was finally revealed by Alexandr Medvedev:¹⁸⁵ a draft for an intergovernmental protocol for 2006, a project for a contract for the supply of gas and an addition to the contract for 2003-2013 signed in June 2002 between Gazprom and Naftohaz specifying the amount and terms of transit of Russian gas through Ukraine. The price basis was to be US\$230tcm while the transport fee paid to Ukraine would increase to US\$2.5tcm/100km. When Ivan Plachkov persisted on the price of US\$65tcm Medvedev readily counter-replied proposing that the difference be paid through shares in a transportation consortium as pledged in 2002.¹⁸⁶

With Ivchenko pointing to the unavoidable fact that prices had to rise for internal consumers and that regardless of whether and how much Russian and Turkmen prices finally increased,¹⁸⁷ Ivan Plachkov made a concession and sent a proposal in which Ukraine would assume a price of US\$80tcm for the first semester of 2006 and where the transport tariff would be raised by 60% (US\$1.75tcm/100km); otherwise Ukraine would automatically siphon off 15% of gas transiting Ukraine towards the rest of Europe.¹⁸⁸ Prices around US\$220tcm to US\$230tcm as Gazprom was insisting were accepted in principle, but not before 2009. If these conditions, which had been officially sent to Gazprom on 27th December, were not accepted, then Gazprom would be sued before the Stockholm Court.¹⁸⁹

As the very last stage for negotiations had come with only a few days left before the fateful date of 1st January 2006, a delegation from Naftohaz flew to Moscow on 27th December trying to reach a late hour agreement.¹⁹⁰ One day later came Ivan Plachkov with a new offer containing some concessions: a transit tariff of US\$2tcm/100km and a price of US\$95tcm,¹⁹¹ moving thus from the threshold of US\$80tcm which had been the maximum Ukraine had been willing to accept so far. A second instruction read that Ukraine would be ready in case of failure to siphon off gas transiting the country for its own needs at the expense of other European consumers. No agreement was reached yet, but conversations

¹⁸⁵ As Prime Minister Ekhanurov would later acknowledge in a press conference, Gazprom had indeed handed over a proposal to Ukraine, where the price was US\$230tcm and was thus considered as unacceptable (See: Matarykin, Vitaly: "Ukraine to take Gazprom to court, if its proposals rejected – PM", *Itar-Tass*, 28 December 2005 (Accessed on the 28th August 2011, from East View, Harvard Libraries).

¹⁸⁶ *Ibid.*

¹⁸⁷ Nekrasova, Galina: "Ukraine's Naftogaz seeks to hike gas prices for all consumers", *Itar-Tass*, 26 December 2005 (Accessed on the 29th August 2011, from East View, Harvard Libraries). Ivchenko had already previously pointed to such an increase, talking of a 25% hike for internal consumers (see: Bondarenko, "Gazovyi nerv", *op. cit.*

¹⁸⁸ Counter to what Ivchenko had at some point promised in early December, but in line with the many threats the latter had often uttered (see: Bondarenko, "Gazovyi nerv", *op. cit.*).

¹⁸⁹ Matarykin, "Ukraine to take Gazprom to court", *op. cit.*

¹⁹⁰ Rzhnevsky, "Ukraine ready for possible", *op. cit.*

¹⁹¹ That is in fact the price Ukraine would end up paying for all its imported gas (Russian and Central Asian) according to the complicated arrangement that was to end the energy dispute.

were not stopped.¹⁹² Given that the Press Agency *Itar-Tass* still echoed the former proposal of gas at US\$80tcm¹⁹³ and that Yushchenko himself publicly pointed to a price range from US\$75tcm to US\$80tcm¹⁹⁴, it behoves us to consider how far the Ukrainian side was really ready to make concessions, independently of the fact that the latest figure of US\$95tcm was quite unlikely to satisfy Gazprom. Instead of coming closer to the Ukrainian positions after the latest relaxation, President Vladimir Putin only advocated an internationally secured credit line of up to US\$3.5bill to Ukraine to assume the price transition.¹⁹⁵

Confusion in Turkmenistan as for agreements with Naftohaz and Gazprom and last negotiations

In addition to the critical situation in which talks stood at that moment, disquieting news came from Turkmenistan, where the Ukrainian negotiators had reached a final agreement, but where, faithful to his capricious negotiating style, the Turkmenbashi had later signed another agreement with Russia which stood in clear contradiction with the former. The deal reached by Gazprom implied that Russia would buy up to 30bcm of gas at the higher price of US\$65tcm.¹⁹⁶ The agreement with Ukraine foresaw that 40bcm would be imported in line with the 38bcm it finally had imported during the current year,¹⁹⁷ whereas although not specified initially, Ukraine was offering US\$60tcm. However, unless Turkmenistan dramatically increased its extraction capabilities in 2006, something which was not possible at least for the time being,¹⁹⁸ both contracts could not be simultaneously honored. Given both the monopsonistic power enjoyed by Russia and the fact that Gazprom had offered a better price, it was fair to assume that

¹⁹² Butrin, Dmitrii' and Nai'em, Mustafa: "Gazovaia voï'na. Viktor Khristenko ne gotov otkazat' Ukraine srazu (Газовая война. Виктор Христенко не готов отказать Украине сразу)", *Kommersant*, 29 December 2005 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁹³ Petrov, Mikhail: "Ukraine ready for market settlements, but price issue still open", *Itar-Tass*, 29 December 2005 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁹⁴ "Russia, Ukraine to make final attempt to solve gas problem Friday", *Itar-Tass*, 30 December 2005 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

¹⁹⁵ Petrov, Mikhail: "URGENT - Putin offers commercial gas loan to Ukraine", *Itar-Tass*, 29 December 2005 (Accessed on the 29th August 2011, from East View, Harvard Libraries); Aglamishi'an, Varvara: "Vladimir Putin predlozhl Ukraine zaniat' deneg na rossii'skii' gaz (Владимир Путин предложил Украине занять денег на российский газ)", *Izvestiia*, 30 December 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹⁹⁶ Zlodorev, Dmitry: "Russia to purchase Turkmen gas at 65 dlr. per 1,000 cubic meters", *Itar-Tass*, 29 December 2005 (Accessed on 31st August 2011, from East View, Harvard Libraries); "'Gazprom" perekupaet gaz u Turkmenbashi ("Газпром" перекупает газ у Туркменбаши)", *Ukrainskaia Pravda*, 29 December 2005, at <http://www.pravda.com.ua/rus/news/2005/12/29/4395428/> (Accessed on the 20th October 2012).

¹⁹⁷ Roberts, J.: "Turkmenistan promises on gas appear much bigger than its ability to deliver", *Energy Economist*, no. 295 (1 May 2006) (Accessed from Université Paris IX – Dauphine by Interlibrary Loan on the 14th September 2012).

¹⁹⁸ See: *Ibid.*

Ukraine would be in the hands of Gazprom to ensure delivery of most of the gas it needed from Central Asia, especially bearing in mind that Russia was offering a higher price.¹⁹⁹

On the very eve of the New Year, Gazprom was declaring its willingness to spend the whole day if necessary until midnight for the sake of finding a suitable solution to finally avert a crisis.²⁰⁰ Naftohaz was invited to come to Moscow if needed (as the delegation had all of a sudden abandoned the Russian capital) and Ukraine was offered the chance to ship gas at 2005 prices for the first quarter of 2006 if no agreement could be reached by Year's End.²⁰¹ Naftohaz was said to have agreed and the Minister of Energy added that Ukraine was ready for market prices from the second quarter.²⁰² Although this late hour news should have sufficed to calm Russian, Ukrainian and of course European consumers, the fact is that Russia was still warning European partners of possible problems linked to undersupply if Ukraine siphoned off gas.²⁰³ This stood in clear contradiction with this last compromise. Unfortunately, it proved that the latest warnings were closer to the truth even if Naftohaz still claimed to have accepted all the terms set by Gazprom in the latest proposal.²⁰⁴ Whatever the reason for this confusion, the fact is that no agreement had been reached and a dispute seemed unavoidable.

6. 5. The Gas Dispute Leads to Supply Cuts: 1 January to 4 January

On the 1st January of 2006 gas still flowed through Ukraine. However Naftohaz soon reported a lower pressure, even if the national distributor "Gaz Ukrainy" answered that this had not impacted on

¹⁹⁹ See: Grishin, Alexandr and Bazak, Oleg: "Otmoroozhennye vseh zamoroziat (ОТМОРОЖЕННЫЕ ВСЕХ ЗАМОРОЗЯТ)", *Moskovskii' Komsomolets*, 31 December 2005 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

²⁰⁰ "Gazprom" s somoletom zhdet ukrainsev, kotorye vnezapno uliteli ("Газпром" с самолетом ждет украинцев, которые внезапно улители), *Ukrainskaia Pravda*, 31 December 2005, at <http://www.pravda.com.ua/rus/news/2005/12/31/4395495/> (Accessed on the 25th October 2012).

²⁰¹ *Ibid.*; "Putin dal Ukraine poldnia na razmyshleniia (Путин дал Украине пол дня на размышления)", *Ukrainskaia Pravda*, 31 December 2005, at <http://www.pravda.com.ua/rus/news/2005/12/31/4395494/> (Accessed on the 25th October 2012).

²⁰² "'Naftogaz" i "Gazprom" tikhon'ko dogovorilis' ("Нафтогаз" и "Газпром" тихонько договорились?)", *Ukrainskaia Pravda*, 31 December 2005, at

<http://www.pravda.com.ua/rus/news/2005/12/31/4395501/> (Accessed on the 25th October 2012).

²⁰³ "Rossiia nachala preduprezhdai' evropei'tsev o problemakh (Россия начала предупреждать европейцев о проблемах)", *Ukrainskaia Pravda*, 31 December 2005, at

<http://www.pravda.com.ua/rus/news/2005/12/31/4395496/> (Accessed on the 25th October 2012).

²⁰⁴ "'Naftogaz Ukrainy" vpolnit usloviia Rossii po gazu («Нафтогаз Украины» выполнит условия России по газу)", *Kommersant*, 1 January 2006, at <http://kommersant.ua/news/988502/> (Accessed on the 25th October 2012): Naftogaz seemed to be rather pointing to an agreement for the first quarter, something that was subsequently confirmed by "Gazprom" itself (See: Zlodoret, Dmitry: "Gazprom says Ukraine agreed to gas prices only for 1st quarter", *Itar-Tass*, 1 January 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries). As the *Guardian* mentioned, it seems that after all Russia did concede on subsidized prices for the first quarter only in exchange for signing a full transition to market prices of US\$230tcm from the second quarter (See: Parfitt, Tom: "Russia turns off supplies to Ukraine in payment row, and EU feels the chill", *The Guardian*, 2 January 2006, at

<http://www.guardian.co.uk/world/2006/jan/02/russia.ukraine> (Accessed on the 25th October 2012).

consumers yet.²⁰⁵ These reports were in full accordance with the decision taken by Gazprom on the eve and duly forwarded to the Ukrainian side that at 10am supplies for Ukraine were to be suspended.²⁰⁶ This decision was later confirmed in a press conference by Mr. Kuprianov himself.²⁰⁷ The dispute soon led to controversies: The first one concerned the real volumes of gas that had been cut. Naftohaz accused Gazprom of having reduced gas volumes by 187mcm; Gazprom however denied this categorically and stated that the real figure was only 120mcm.²⁰⁸ This exchange of accusations and the disagreement regarding the gas that was flowing were closely related to the effects the European consumers started feeling and which clearly pointed to a gas diversion by Ukraine to make up for lost supplies. In such context, Ukraine's accusation might have been determined by the need to deny any responsibility and thus make Gazprom fully responsible for undersupplies in the rest of Europe.

The energy dispute evolves into an energy crisis for European consumers

The fact is that whoever was responsible, from the very beginning European customers started feeling the effects of the dispute with pressure effectively falling in those countries most dependent on Russian gas supplies due to their high proportion of Russian gas in their energy mix. Poland and Hungary for example suffered a drop in gas pressure of 14% for the former (reserves were to last for one week) and a bigger reduction of 25% for the latter, where the biggest firms started switching to oil.²⁰⁹ Apart from these two countries, Austria also reported a drop of 20% whereas Slovakia, which did not provide immediate details, also reported lesser pressure even if consumers seemed not to be affected yet. Big consumers of Russian gas such as Germany and France did not yet report yet any problems in supply, but Germany announced its readiness to eventually apply cuts to big firms if needed to protect supply to the population in the event supply problems.²¹⁰ The fall in supplies would become even worse on the next day, with Poland and Hungary reporting a fall of as much as 40%, while Italy also started suffering from a reported

²⁰⁵ Matarykin, Vitaly: "Ukraine confirms pressuring in national gas pipelines lowering", *Itar-Tass*, 1 January 2006 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

²⁰⁶ "Gazprom suspends gas shipments (sic) to Ukraine", *Gazprom Press*, 1 January 2006, at <http://www.gazprom.com/press/news/2006/january/article88140/> (Accessed on the 25th October 2012).

²⁰⁷ "Rossiia nachala zakruchivat' kran (Россия начала закручивать кран)", *Ukrainskaia Pravda*, 1 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/1/4395505/> (Accessed on the 26th October 2012).

²⁰⁸ Zlodorev, Dmitry: "Gazprom denies Ukraine's claim gas supplies cut by 187 mln cub m", *Itar-Tass*, 1 January 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁰⁹ "Ukraine gas row hits EU supplies", *BBC*, 1 January 2006, at <http://news.bbc.co.uk/2/hi/europe/4573572.stm> (Accessed on the 25th October 2012).

²¹⁰ "Gas row sends shiver through EU", *BBC*, 2 January 2006, at <http://news.bbc.co.uk/2/hi/europe/4574264.stm> (Accessed on the 25th October 2012).

loss of 25% in its usual supply.²¹¹ The crisis also harshly affected countries like Serbia, Bosnia²¹² and Moldova.

As the dispute easily developed into a supply crisis in many countries in Central Europe, Gazprom accused Ukraine of siphoning off gas and thus provoking the reported supply problems in all the above mentioned countries.²¹³ Naftohaz immediately denied such accusations,²¹⁴ pointing to the fact that it had enough reserves to withstand the winter without having customers affected (the exact volume remained undisclosed as this was a state secret, although total capacity was supposed to reach 32bcm),²¹⁵ even if Ukraine warned that the industrial sector might eventually have to be a target for restrictions if the situation continued.²¹⁶ Gazprom, through Alexandr Medvedev, reiterated its accusations on 3rd January and even stated that the seizure of gas had been even greater on 2nd than on 1st January.²¹⁷ Gazprom's spokesman, Sergei Kuprianov provided some exact details on the volumes allegedly diverted: according to him, Ukraine had diverted ("stolen" was the blunter termed used) 104.8bcm of gas between 10am of 1st January and 10am of 2nd January to which 118.7bcm were to be added from the next 24 hours until 3rd January. His Ukrainian counterpart from Naftohaz, Eduard Zaniuk, simply denied "having stolen 100bcm" as stated by Gazprom.²¹⁸

These reproaches played into the hands of Gazprom and Naftohaz as statements easily became instruments of propaganda and possibly too, disinformation. For example, Naftohaz defended its position when it underlined Gazprom's recognition that it had not been supplying the full amounts of gas.²¹⁹ That had been obvious since the very beginning and would not have led to a lack of supplies for end customers

²¹¹ "La minaccia, Gas, mezza Europa a secco", *La Repubblica*, 3 January 2006, at <http://ricerca.repubblica.it/repubblica/archivio/repubblica/2006/01/03/la-minaccia-gas-mezza-europa-secco.html> (Accessed on the 26th October 2012).

²¹² "Evropa nedoschitalas' ogromnykh ob'emov gaza (Европа недосчиталась огромных объемов газа)", *Ukrainskaia Pravda*, 2 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/2/4395527/> (Accessed on the 25th October 2012).

²¹³ Elovsky, Konstantin: "Amount of gas stolen by Ukraine increased Tuesday", *Itar-Tass*, 3 January 2006 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

²¹⁴ Matarykin, Vitaly: "Ukraine rejects Gazprom accusations of stealing gas", *Itar-Tass*, 3 January 2006 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

²¹⁵ Nekrasova, Galina: "West Ukraine still unaffected by pipeline pressure decreases", *Itar-Tass*, 1 January 2006 (Accessed on the 30th August 2011, from East View, Harvard Libraries); Matarykin, Vitaly: "Naftogaz Ukrainy says consumers unaffected by gas supply cuts yet", *Itar-Tass*, 1 January 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²¹⁶ Parfitt, *op. cit.* As would be demonstrated in 2009, when the cut-off lasted almost three weeks, Ukraine had indeed huge emergency reserves, but had most of its storage facilities located in the West. In order to supply the industrial core in Eastern Ukraine, it had to use the gas network in reverse. This automatically precluded letting in flows of gas coming from Russia as, otherwise, reverse use would be precluded. It is therefore understandable that in 2006 the Ukrainian government warned that industries (and the Eastern population too, after all) might suffer from the situation.

²¹⁷ Elovsky, *op. cit.*

²¹⁸ Matarykin, "Ukraine rejects Gazprom", *op. cit.*

²¹⁹ "La minaccia", *op. cit.*; "Rossiia priznala, chto nedodala gaza evrope i poobeshchala ispravits'ia (Россия признала, что не додала газа Европе и пообещала исправиться)", *Ukrainskaia Pravda*, 2 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/2/4395534/> (Accessed on the 26th October 2012).

in other European countries, unless either Ukraine siphoned off volumes equal to what Gazprom was discounting, or Russia consciously reduced supplies beyond volumes discounted for Ukraine in order to take other countries hostage and convincingly portray Ukraine as a robber. To reinforce their arguments, Ivan Plachkov stated that Ukraine was not consuming Russian gas but only gas from Turkmenistan and its own storages (gas from Ukraine's own internal production).²²⁰ This went in the line of President Yushchenko, who had from the beginning stated that not even technical gas needed for powering transit flows was being taken from Russian gas, but was coming from Ukraine's own reserves instead.²²¹ The Prime Minister, Iurii' Ekhanurov confirmed this and also announced that Russia had not stopped supplies from Turkmenistan.²²² If true this would confirm that Ukraine could indeed cope with temporary shortages, even if the Minister of Energy somehow contradictorily later warned that in case of necessity (extreme temperatures) they might have, entitled as they were, to collect the gas due as transit tariff.²²³ However, soon doubts surfaced about the Ukrainian version. On 2nd January, Dmitry Medvedev clearly contradicted Ukrainian information when he stated that Ukraine was only receiving Russian gas and that no Turkmen gas had reached its transportation system.²²⁴ Explanations by Gazprom's Press-Secretary, Sergei' Kuprianov vaguely pointed to this: he stated that Gazprom had contracted volumes of Turkmen natural gas for 2006; however, the Central Asian Pipeline System having limited capacity, no confirmation could be given as to Ukraine's contracted Turkmen gas.²²⁵ As the daily *Kommersant* was to report some days later, Russia had indeed stopped Turkmen supplies to Ukraine at 10am on 1st January, thus using its unique position as transit country for shipments from Central Asia. This would be

²²⁰ "La russia, Gli ucraini stanno rubando il gas Ue", *La Repubblica*, 3 January 2005, at <http://ricerca.repubblica.it/repubblica/archivio/repubblica/2006/01/03/la-russia-gli-ucraini-stanno-rubando-il.html?ref=search> (Accessed on the 26th October 2012).

²²¹ "Iushchenko: Ukraina ne voruet gaz u Evropy, a otdaet ei' svoi' (Ющенко: Украина не ворует газу Европы, а отдает ей свой)", *Ukrainskaia Pravda*, 1 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/1/4395516/> (Accessed on the 26th October).

²²² "Rossiia uvidela, chto Ukraina voruet evropei'skii' gaz (Россия увидела, что Украина ворует европейский газ)", *Ukrainskaia Pravda*, 1 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/1/4395515/> (Accessed on the 26th October 2012).

²²³ "Ukraina пока obkhoditsia bez rossii'skogo gaz – Plachkov (Украина пока обходится без российского газа – Плачков)", *Ukrainskaia Pravda*, 2 January 2006 (Accessed on the 26th October 2012); "Ukraina voz'met rossii'skii' gaz tol'ko kogda zamerznet (Украина возьмет российский газ только когда замерзнет)", *Ukrainskaia Pravda*, 3 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/3/4395573/> (Accessed on the 30th October 2012).

²²⁴ "Rossiia poschitala, skol'ko ukrala Ukraina, i otpravila ekspertov (Россия посчитала, сколько украла Украина, и отправила экспертов)", *Ukrainskaia Pravda*, 2 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/2/4395524/> (Accessed on the 26th October 2012).

²²⁵ "'Naftogaz' ne khochet brat' u Rossii gaz dlia Evropy ('Нафтогаз' не хочет брать у России газ для Европы?)", *Ukrainskaia Pravda*, 2 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/2/4395542/> (Accessed on the 30th October 2012).

confirmed quite bluntly by Gazprom at Minister Khristenko's press conference before international media days after the dispute ended.²²⁶

Gazprom decides to deescalate the dispute and restores supply while negotiations continue

Given the situation and faced with the dilemma of having to sustain a gas cut-off against Ukraine which affected Central European customers, who had become hostages to the dispute, Gazprom backpedaled and decided on 2nd January to increase the flow of gas and thus restore usual volumes as prior to the dispute.²²⁷ Gazprom announced that an additional volume of 95mcm had been pumped into the pipelines in the direction of the rest of Europe to make up for the fall in pressure. At the same time, Alexandr Medvedev announced that normal supply would have been restored by the next day²²⁸ and promised to take every measure to ensure that affected consumers would receive contracted supplies.²²⁹ As promised, on 3rd January the global volumes pumped by Gazprom reached the usual figure of 360mcm per day (as confirmed by Naftohaz) and full supply was fully restored to the rest of European countries,²³⁰ at the obvious price of Naftohaz being able to receive all the gas needed for its economy, taking in fact more than on the first day of the dispute, with a consumption of 118.7mcm per day instead of 104mcm.²³¹

With Gazprom having soon restored normal supply, the energy crisis in countries consuming Gazprom's gas proved short, especially in the face of the fact that the bilateral dispute as such had not been yet solved. It still remained for Russia and Ukraine to find a solution that would preclude further cuts in the coming days. A delegation from Naftohaz was to land in Moscow on 3rd January in order to end the deadlock in negotiations.²³² This time, negotiations were short and finally after almost a year of tensions and frustration, an agreement was reached on 4th January 2006.

²²⁶ Butrin, Dmitrii': Gazovaia voi'na. Koktei'l' Millera (Газовая война. Коктейль Миллера)", *Kommersant*, 10 January 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries); Kolesnikov, Andrei': ""Im prosto bylo nechem kryt"" (Им просто было нечем крыть), *Kommersant*, 10 January 2006 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

²²⁷ "Situation forces Gazprom to supply extra amounts of gas to Europe", *Itar-Tass*, 3 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²²⁸ ""Gazprom" ne priznavalsia v otbore gaza. On spasal Evropu ot Ukrainy ("Газпром" не признавался в отборе газа. Он спасал Европу от Украины)", *Ukrainskaia Pravda*, 2 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/2/4395540/> (Accessed on the 30th October 2012).

²²⁹ ""Gazprom" obeshchaet spasti Evropu ("Газпром" обещает спасти Европу)", *Ukrainskaia Pravda*, 2 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/2/4395529/> (Accessed on the 30th October 2012).

²³⁰ Matarykin, Vitaly: "Gas transit to Europe via Ukraine reaches 360 mln. cms", *Itar-Tass*, 3 January 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²³¹ "Rossiia zametila, chto Ukraina stala vorovat' bol'she (Россия заметила, что Украина стала воровать больше)", *Ukrainskaia Pravda*, 3 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/3/4395549/> (Accessed on the 30th October 2012).

²³² "Gazprom not to make any more concessions to Ukraine", *Itar-Tass*, 3 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

6. 6. The 4th January 2006 Agreement

The agreement, which by the way, caused a political storm in Ukraine and led to Ekhanurov's government fall, was valid for five years, from 2006 to 2011 and had been signed between Gazprom, Naftohaz and the obscure trader RosUkrEnergo.²³³ This agreement put a final end to long months of negotiations but was distinctive complex. The confusion that derived from the many points that were unclear led to different interpretations, which took some days, if not weeks, to be clarified.

Provisions of the new agreement

The agreement appeared at first sight as an absolute Russian victory. The reason for this was that the agreement stated that Russia would sell its gas at the maximum price it had been insisting on at the last stages of the dispute, US\$230tcm (article 4).²³⁴ Accordingly, the transit tariff would also rise and moved thus from US\$1.09tcm/100 km to US\$1.6tcm/100 km (article 1). This would somehow compensate for Ukraine the blow of a nearly five-fold price increase. Apart from that, as could be deduced from the agreement, the transit tariff would no longer be paid in kind but integrally in cash (article 2). The total amount of gas that Russia was to provide to Ukraine would be reduced to 17bcm for the year 2006 (article 4); now that Russia no longer had to pay with low-priced gas in kind as payment of the transit tariff, the volumes were significantly reduced.

Confusion regarding the new pricing scheme

When the agreement was known, both parties hailed it as beneficial and as the normal result of their having stood their ground and secured their interests. Russia, as seen in the paragraph above, managed to bind Ukraine to a new five year agreement where payments were finally monetized and where, more important, market prices had been secured;²³⁵ it was claimed that prices in fact would not have to be renegotiated, as they would be automatically revised every quarter of a year according to the evolution of the oil prices to which gas was pegged.²³⁶

²³³ See the copy, as published by the daily *Ukrainska Pravda*, in: "Tekst soglasheniia mezhdu "Naftogazom" i "Gazpromom" (Текст соглашения между "Нафтогазом" и "Газпромом")", *Ukrainskaia Pravda*, 5 January 2006, at <http://www.pravda.com.ua/rus/articles/2006/01/5/4395629/> (Accessed on the 5th November 2012).

²³⁴ "Gazprom, Naftogaz Ukrainy agree on 230 dollar gas price", *Itar-Tass*, 4 January 2006 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

²³⁵ Chai'ka, Fedor: "Rossiia dobilas' povysheniia tsen na gaz (Россия добилась повышения цен на газ)", *Izvestiia*, 10 January 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

²³⁶ Veletminskii', Igor': "Evropei'skaia formula tseny (Европейская формула цены)", *Rossii'skaia Gazeta*, 11 January 2006 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

However, Ukraine also had arguments to claim this agreement as a victory for its interests: Ukraine insisted that the final price Ukraine would pay was US\$95tcm (article 4) and hailed as very positive that the transit tariff would rise and be paid in cash. At first reading Ukraine's arguments did not look very consistent with the provisions of the agreement. Regarding the transit tariff, Ukraine was quite far from having achieved a transit tariff of around US\$4tcm/100km, which is the rough price for having fully absorbed the impact of gas prices skyrocketing from US\$50tcm to US\$230tcm; the reduction of volumes of Russian natural gas from 28-23bcm to 17bcm could be guessed as a direct consequence of a more disadvantageous proportion between transit tariff and gas prices. Regarding the final price of US\$95 this seemed to be the result of calculating the median price between Turkmen and Russian supplies. This in fact seriously seemed to distort the whole picture and easily served Ukraine to show the agreement in a positive light, as such a calculation could also have been made before the dispute during negotiations that unfolded in 2005.

The expanded role of RosUkrEnergo and the new natural gas mix: added confusion

However, beyond the political use that could be made from it, this median calculation was at the same time justified for an important fact, which is the new role that RosUkrEnergo was to acquire as monopolist (article 2). Henceforth all gas imports would be sold by the intermediary and all this gas, irrespective of its geographical origin, once bought by the trader, would be then "mixed" before being sold to Ukraine. This forces us to look closer at one of the most obscure elements of the agreement, which is the new breakdown of gas imports.

Regarding the origin of gas, the main question was concerned with new proportions of Central Asian gas which would be integrally traded through RosUkrEnergo. As we may remember, Turkmenistan had ended up signing two contradictory agreements with both Russia and Ukraine. The result of this was that Turkmenistan ended up committing excessive volumes of gas. However, as Mr. Kuprianov had himself hinted on the eve of the dispute, Gazprom had both offered the best price and enjoying power derived from its monopsonistic situation, it was considered to have contracted nearly the total of all available Turkmen exports through Russia. Gazprom's position regarding Turkmen gas would now become more complex as a result of RosUkrEnergo's role.

It is safe to assume that Gazprom, which had gained a year in advance the same monopoly that was foreseen for the following year 2007, would now lose a great deal of influence over a strategic asset in favor of RosUkrEnergo, as most of the Turkmen gas would be contracted for Ukraine. What was even

more surprising is that Ukraine was not only entitled to import Turkmen gas, but also additional volumes from Kazakhstan and Uzbekistan. The whole breakdown of all the gas that Ukraine was entitled to receive was the following: 41bcm from Turkmenistan, a maximum of 7bcm from Uzbekistan, a maximum of 8bcm from Kazakhstan, and a maximum of 17bcm of Russian gas (article 4).²³⁷

This breakdown was precisely the main source of confusion (see explanation further below), and this for two reasons: First, the total amounted to more than what Ukraine needed for gas imports (Ukraine consumed in 2006 74bcm,²³⁸ with an internal production of 20.7bcm,²³⁹ so it would import 53.3bcm²⁴⁰). Second, RosUkrEnergo was supposed to export only 34bcm in the first half of 2006 but as much as 58bcm to Ukraine in 2007 (article 4), from which 15bcm were meant for re-exporting in cooperation with Gazexport (article 4).²⁴¹

As we see below, several analysts tried to tackle the task of finding an explanation for the several loopholes in this agreement (or at least those elements that were published) and discussed who the real winner in the dispute had been.

Reactions and differing interpretations as for the controversial agreement

Assessments from the Ukrainian side

Many assessments coming mostly from the Ukrainian side considered that Ukraine had clearly lost in face of Russian pressure. The Ukrainian political scientist, Andrei´ Ermolaiev, for example considered that gas

²³⁷ Chizhov, Maxim: "Kak iz \$230 sdelat' \$95 (КАК ИЗ \$230 СДЕЛАТЬ \$95?)", *Argumenty I Fakty*, 11 January 2006 (Accessed on the 20th August 2011, from East View, Harvard Libraries). A good deal of confusion covered the breakdown in the days following the crisis: *La Repubblica* for example talked of only 34bcm of Central Asian gas ("Gas, compromesso tra Mosca e Kiev", *La Repubblica*, 5 January 2006, at <http://ricerca.repubblica.it/repubblica/archivio/repubblica/2006/01/05/gas-compromesso-tra-mosca-kiev.html> (Accessed on the 5th November 2012), which were the volumes corresponding to the first half of the year.

²³⁸ IHS CERA: "Natural Gas and Ukraine's Energy Future", Ministry of Energy and Coal Industry of Ukraine (February 2012), p. 4, Figure ES-2, at <http://s05.static-shell.com/content/dam/shell-new/local/country/zaf/downloads/pdf/research-reports/Ukraine-Policy-Dialogue-report.pdf>.

²³⁹ Pirani, "Ukraine's gas sector", *op. cit.*, p. 28, Table 4.1., at http://209-20-84-91.slicehost.net/assets/2009/2/3/Ukraine_s_Gas_Sector.pdf.

²⁴⁰ According to Simon Pirani's calculations, in 2006 the total imports for Ukraine were slightly more: 54.9bcm (See: Pirani, "Ukraine: A gas dependent state", *op. cit.*, Table 3, p. 98).

²⁴¹ The article by Aleksandr Frolov, *Sovetskaia Rossiia*, tried an assessment figuring out the differences between 2006 and 2007, together with the figure of 15bcm for re-export (see: Frolov, "Skhema", *op. cit.*). However, the figure given for 2006 seemed to correspond to the first half of the year. This would explain the mismatch between figures given for supplies bought by RosUkrEnergo and those sold to Ukraine (This can be deduced from: Reznik, Irina and Bekker, Aleksandr: "Voi´na ne okonchena (Война не окончена)", *Vedomosti*, 13 January 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries). As for the supposition made then that Turkmenistan would continue supplying gas (at least part of it) directly to Naftohaz, see: Len´, Olga: "Sub´ekt razdrazheniia (СУБЪЕКТ РАЗДРАЖЕНИЯ)", *Moskovskie Novosti*, 13 January 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries); Fokina, Ekaterina: "Gazovy´ marafon (Газовый марафон)", *Profil´*, 16 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

in possession of RosUkrEnergo was de facto in possession of Gazprom, Naftohaz having thus lost gas that belonged to it as payment for transit.²⁴² Another political scientist, Taras Vozniak, saw the dispute and the subsequent agreement through the political prism and adhered to the idea of Russian political motivations meant to restore its position both in the CIS and among European countries.²⁴³ These two interpretations, either based on the economic or the political factor were the most common in Ukraine.

Leaving aside the possible political considerations, it is worth delving into the economic aspect: Regarding the median price of gas sold by RosUkrEnergo, as already mentioned above, Ukraine had on the one hand not been able to prevent a significant price hike, as Gazprom's gas increased to US\$230tcm and gas from Central Asia, whose prices also increased yielded US\$95tcm once all gas was mixed by RosUkrEnergo. On the other hand though, it must be highlighted that this price surpassed the US\$80tcm (maximum set during pricing negotiations) by a relatively short margin, even if, as we may remember, US\$95 was proposed at some point (see p. 157).

Regarding RosUkrEnergo, the usual interpretation from the Ukrainian side was to see it as a tool of Gazprom, so its increased role supposed a victory for Gazprom. For example, if we were to believe specialists, as consulted by *Moskovskaia Pravda*, the result was a victory of Gazprom and RosUkrEnergo, which became the monopolists in gas transportation to Ukraine; this assessment was reinforced by the assumption that in the future, Gazprom and not the financially poor Naftohaz would be able to gain a majority in RosUkrEnergo's stakes.²⁴⁴ Most scathing criticisms came from the side of the Ukrainian opposition, in particular former Prime Minister Tymoshenko who accused the government of giving in to Ukraine's interests outright.²⁴⁵

Alla Eremenko from the weekly *Zerkalo Nedeli* clearly attributed the victory to Russia, as the figures obtained from the agreement were similar to those Gazprom had been calculating for the company's balance for 2006 and because Naftohaz had not been able either to achieve a price equal to or lower than US\$80tcm and had accepted a new transit tariff of US\$1.6tcm/100 km that would remain

²⁴² ""Gazovyi kontrakt": vynuzhdennaia dogovorennost', pobeda ili sdacha interesov? ("Газовый контракт": вынужденная договоренность, победа или сдача интересов?)", *Ukrainskaia Pravda*, 4 January 2006, at <http://www.pravda.com.ua/rus/articles/2006/01/4/4395607/> (Accessed on the 6th November 2012).

²⁴³ Vozniak, Taras: "Chogo dobyvaet'sia Putin? Geopolitichnii aspekt gozovogo kontrnastupu Rosii' (Чого добивається Путін? Геополітичний аспект газового контрастupu Росії)", *Ukrainska Pravda*, 3 January 2006, at <http://www.pravda.com.ua/articles/2006/01/3/3045564/> (Accessed on the 6th November 2012).

²⁴⁴ Laskin, Konstantin: "Nochnoi dogovor (Ночной договор)", *Moskovskaia Pravda*, 6 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁴⁵ Eremenko, Alla: "Shalom gazavat, slaviane (Шалом газават, славяне!)", *Zerkalo Nedeli*, 14 January 2006, at http://zn.ua/ARCHIVE/shalom_gazavat_slavyane-45646.html (Accessed on the 6th November 2012).

unchanged for five years in spite of possible price increases over this period.²⁴⁶ The author also delved into the composition of RosUkrEnergo and linked it to both Russian and Ukrainian interests (Gazprom for the former and Iurii´ Boi´ko, one of the grey eminences of Kuchma´s clique for the latter), thus following the interpretation of RosUkrEnergo as Gazprom´s tool and highlighting the fact that Gazprom would be able to shut out Ukraine from direct contracts with Central Asia and keep its monopoly in that region.²⁴⁷

Evgeniia Fokina from *Profil´* also found in the new arrangement benefits for Gazprom, as she surmised RosUkrEnergo (with Gazprom behind) could pressure Naftohaz in the future regarding part of the Turkmen gas belonging to the company in payment of transit services (22bcm as calculated by the author) and resold to Naftohaz,²⁴⁸ while analyst Mikhail Leont´ev pointed to another advantage, which is that as a foreign registered company, gas exported by RosUkrEnergo would be exempted from paying customs duties.²⁴⁹ An article at the *Kyiv Post* by Konstantin Borodin, at the time director of the Kyiv´s Energy Research Center and having served as an advisor to Iurii´ Boi´ko, head of Naftohaz Ukrainy in 2002-2005, said that the arrangement involving RosUkrEnergo was made as a means for Naftohaz to save face after having lost the dispute.²⁵⁰ It must be underlined that Naftohaz had been investigated on the orders of Oleksandr Turchinov, Head of the Security Service (SBU) under Timoshenko´s government during the summer 2005 and RosUkrEnergo´s alleged ties with the former direction under Iurii´ Boi´ko were one of the main targets.²⁵¹

Assessments from the Russian side

However, other interpretations yielded totally different conclusions. In the coming days during the month of January, two articles which appeared in *Kommersant* and *Vedomosti* focused on Gazprom´s real yield from the dispute and showed a more nuanced picture: Russia had been working since 2001 to monopolize all Central Asian gas exports but now this position would have to be shared with RosUkrEnergo, even if with the ownership of 50% of the company, the trader was far from being alien to Gazprom. However,

²⁴⁶ *Ibid.*; scathing critics of Russia, this time from the Russian press, can be found in: Filin, Dmitri: "Diletant v Kremle (ДИЛЕТАНТ В КРЕМЛЕ)", *Zavtra*, 11 January 2006 (Accessed on the 27th August 2011, from East View, Harvard Libraries); "Gazovyi´ krizis. Kremlevskii´ gambit? (ГАЗОВЫЙ КРИЗИС. КРЕМЛЕВСКИЙ ГАМБИТ?)", *Slovo*, 13 January 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

²⁴⁷ Eremenko, "Shalom", *op. cit.*

²⁴⁸ Fokina, "Gazovyi´", *op. cit.*

²⁴⁹ Leont´ev, Mikhail: "Kontrol´ za truboi´ (КОНТРОЛЬ ЗА ТРУБОЙ)", *Argumenty i Fakty*, 18 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁵⁰ Borodin, Konstantin: "RosUkrEnergo: predator or victim?", *Kyiv Post*, 15 February 2006, at <http://www.kyivpost.com/opinion/op-ed/rosukrenergopredator-or-victim-23869.html> (Accessed on the 20th November 2012).

²⁵¹ Gavrish, Oleg; Kuz´myn, Andrei; Grib, Natalia: "Sluzhba bezopasnosti Ukrainy ishchet aksii RosUkrEnergo (Служба безопасности Украины ищет акции RosUkrEnergo)", *Kommersant*, 15 August 2005 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

that meant that at least 50% of expected earnings would have to be yielded to the obscure owners of the remaining half. Thus out of US\$1.6bill of global benefits that RosUkrEnergo was expected to make, only US\$800tcm mill would actually accrue to Gazprom.²⁵²

According to the company's representative, Wolfgang Putschek, RosUkrEnergo was supposed to buy Central Asian gas from Gazexport at the price of US\$90tcm and then resell it to Ukraine at the agreed price of US\$95tcm;²⁵³ RosUkrEnergo's benefits from the first transaction would be scarce if not non-existent as US\$30tcm were the transit costs.²⁵⁴ The fact that to Turkmen and Uzbek gas priced at US\$65tcm cheap Kazakh gas priced at US\$30tcm could be potentially added into the mix (See Alexei Korchemkin's analysis below),²⁵⁵ means that a certain margin for profits might exist, although it could not be clarified whether Gazexport or RosUkrEnergo would be the one benefiting. This part of the deal was particularly confusing at the beginning due to the two agreements that Turkmenistan had signed with both Gazprom and Naftohaz.

Opposition between the late 2005 agreements signed by Turkmenistan with Naftohaz and Gazprom

As a result, according to *Novaia Gazeta*, it was not clear from whom RosUkrEnergo would buy Turkmen gas, whether from Gazexport or from Naftohaz. The daily informed that in early February, RosUkrEnergo would buy Turkmen gas contracted for Naftohaz priced at \$50tcm and thus sold at the Ukrainian border for US\$80tcm (adding US\$30tcm for transit, between US\$25tcm and US\$30 as calculated by Valerii Nesterov from "Troika Dialog",²⁵⁶ or only US\$19tcm if following one of *Vremia Novostei*' assessments;²⁵⁷ the price of US\$30tcm seems to be the most reliable),²⁵⁸ even if it was later reported that the gas sold to Ukraine would be at a higher price of US\$60tcm.²⁵⁹

²⁵² Butrin, "Gazovaia voi'na", *op. cit.*; Reznik, Irina and Bekker, Aleksandr: ""Gazprom" otdal Ukrainu posredniku ("Газпром" отдал Украину посреднику)", *Vedomosti*, 11 January 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries). Sharing profits with RosUkrEnergo happened already during the past year with Turkmen natural gas, as RosUkrEnergo had started working as intermediary and retained 37 % of the volume of gas (Gazprom earned only half of it) in payment for its services (see for the figures: Frolov, "Skhemy", *op. cit.*).

²⁵³ Belton, Catherine: "Ukraine says it will not buy any gas from Russia", *Moscow Times*, 11 January 2006 (Accessed on 31st August 2011, from East View, Harvard Libraries).

²⁵⁴ Fredholm, *op. cit.*

²⁵⁵ See: Korchemkin, Mikhail: "RosUkrEnergo Wins, Gazprom and NAK Lose", *East European Gas Analysis*, 6 March 2006, at <http://www.eegas.com/ukrtran6.htm> (Accessed on 6th November 2012).

²⁵⁶ Reznik, Irina and Kashin, Vasilii: "RosUkrEnergo ne nuzhna Ukraine (RosUkrEnergo не нужна Украине)", *Vedomosti*, 15 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁵⁷ Grivach, Alexei: "Sredneaziatskaia stavka dlia "Gazproma" (Среднеазиатская ставка для "Газпрома")", *Vremia Novostei*, 23 January 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries). According to Konstantin Chui'chenko, acting director of RosUkrEnergo in representation of Gazprom, costs amounted to US\$25tcm, contrary to the figure of US\$30tcm usually mentioned in most press reports (See: Gavrish, Oleg and Natal'ia Grib: "RosUkrEnergo obnaruzhila u sebia pribyl' (RosUkrEnergo обнаружила у себя прибыль)", *Kommersant*, 13 November 2006 (Accessed on

As for what amount would correspond to Naftohaz and which to Gazprom, confusion reigned too: According to *Vremia Novostei*, RosUkrEnergo would sell a maximum of 26bcm of gas at US\$80tcm to Naftohaz, and the rest, at US\$95tcm to a Joint Venture RosUkrEnergo/Naftohaz (See below);²⁶⁰ still, the author, Alexei Grivach, had published on January totally different figures (repeated again on 20th February): only 5bcm contracted to Gazprom, and 36bcm contracted to Naftohaz.²⁶¹ The latest comes closer to alleged secret contracts signed on 4th January and unveiled by *Zerkalo Nedeli* and they also happen to nearly match the 5bcm that the JV RosUkrEnergo/Naftohaz was eventually to be allowed to sell within Ukraine (see below).²⁶²

In fact, all this information was wrong, as Ukraine would not receive any direct supplies from Turkmenistan, even if the silence the 4th agreement kept on the second half of 2006 raised suspicions about this. However, any profits for RosUkrEnergo out of Central Asian gas derived from its position as intermediary were minor compared to those stemming from gas reexported. The company, which had been called by *Moscow Times* the real winner of the "war" was left with something between 10bcm to 15bcm of gas to be freely exported to Europe²⁶³ (other sources calculated between 15bcm and 20bcm instead).²⁶⁴

Clarifying the main point of contention in the 4th January agreement: the new gas mix

The confusion that existed regarding how much gas RosUkrEnergo would be entitled to re-export (officially the contract talked of 15bcm) was related to the confusion regarding the gas breakdown. The only fixed volumes were those of Turkmen gas (41bcm), whereas Uzbek (7bcm), Kazakh (8bcm) and Russian gas (17bcm) were maxima. It was unknown what gas Ukraine would finally receive, whether

the 31st August 2011, from East View, Harvard Libraries); calculations by Alexei Korchemkin seem to ratify the figure of US\$25tcm (see: Korchemkin, *op. cit.*).

²⁵⁸ Vas'kovskaia, Ianina: "Ukrainu, kazhetsia, kupili (УКРАИНУ, КАЖЕТСЯ, КУПИЛИ)", *Novaia Gazeta*, 9 February 2006 (Accessed on the 31st August 2011, from EastView, Harvard Libraries).

²⁵⁹ Grivach, "Sredneaziatskaia stavka", *op. cit.*

²⁶⁰ Grivach, Alexei: "Turkmenskaia sotnia (Туркменская сотня)", *Vremia Novostei*, 13 February 2006 (Accessed on the 23rd August 2011, from EastView, Harvard Libraries). Another similar reference by *Vremia Novostei* to agreements guaranteeing 26bcm for Naftogaz and 32bcm for UkrGazEnergo (both volumes being provided by RosUkrEnergo), can be found in: Grivach, Alexei: "Kiev snova ne platit (Киев снова не платит)", *Vremia Novostei*, 14 April 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

²⁶¹ Grivach, "Sredneaziatskaia stavka", *op. cit.*; Grivach, Alexei: "Zagazovannyi den' rozhdeniia Turkmenbashi (Загазованный день рождения Туркменбаши)", *Vremia Novostei*, 20 February 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁶² As would eventually be known in the following weeks, Gazprom indeed bought all of Turkmen gas and Ukraine only received it indirectly through RosUkrEnergo's intermediation as agreed on 4th January.

²⁶³ Belton, Catherine: "RosUkrEnergo Emerges as Winner in Gas War", *Moscow Times*, 10 January 2006 (Accessed on the 31st August 2011, from EastView, Harvard Libraries).

²⁶⁴ Grivach, Alexei: "Zadelo za zhivoe (Задело за живое)", *Vremia Novostei*, 15 February 2006 (Accessed on the 22nd August 2011, from EastView, Harvard Libraries).

RosUkrEnergo would re-export all gas it was entitled to, what origin this gas would have and whether this gas was considered as payment for transit tariffs for its services carrying Central Asian gas (RosUkrEnergo had been paid 13bcm of gas during 2005).

This question was essential, as depending on the physical origin of gas, prices could vary for Ukraine. For example, if all Uzbek and Kazakh gas was exported to Ukraine (56bcm resulting from Turkmen, Uzbek and Kazakh gas, almost 3-2bcm more than what Ukraine would eventually need for 2006) no expensive Russian gas would be needed for Ukraine's consumption, whereas Turkmen gas in addition to Russian gas would necessarily yield different prices, unless the gas mix had been already priced by RosUkrEnergo at US\$95tcm independently of the exact origin. In fact, the price of US\$95tcm soon led to suspicions that it was the result of a strictly Central Asian mix. The controversy soon merged and led to acrimonious reproaches and denials. Ukraine obviously stated that no Russian gas was needed,²⁶⁵ whereas Russia insisted on the contrary.²⁶⁶

More Central Asian gas for Naftohaz and the financial consequences

However, Russia soon recognized the rightness of Ukraine's calculation.²⁶⁷ This confirmed the assumption, a logical consequence of Ukraine's only buying Central Asian gas, that Russian gas would be sold to Europe. Once the general picture had been clarified, it was somehow easier to calculate what were the benefits for Gazprom from the agreement.

²⁶⁵ Melnik, Mikhail: "Naftogaz Ukrainy won't buy Russian gas from RosUkrEnergo in 2006", *Itar-Tass*, 6 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); "Ukraine okazalsia ne nuzhen rossii'skii' gaz (Україне оказался не нужен российский газ)", *Ukrainskaia Pravda*, 6 January 2006, at <http://www.pravda.com.ua/rus/news/2006/01/6/4395639/> (Accessed on the 5th November 2012).

²⁶⁶ "Ukraine has to keep buying Russian gas – expert", *Itar-Tass*, 6 January 2006 (Accessed on the 30th August 2011, from East View, Harvard Libraries); see also: Sergeev, Mikhail: "Ukraina oboi'detsia bez rossii'skogo gaza (УКРАЇНА ОБОЙДЕТСЯ БЕЗ РОССИЙСКОГО ГАЗА)", *Vremia Novostei*, 12 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁶⁷ Belton, "RosUkrEnergo Emerges", *op. cit.* Confirmed to be most likely, according to the expert from Oxford University Jonathan Stern (see: Belton, "Ukraine says it will not", *op. cit.*). This issue remained in the next days a matter of face-saving, as when Putin some days thereafter stated in a press conference that indeed, 1/3 of the gas for Ukraine would have a Russian origin (See: Kolesnikov, Andrei': "Podpisannomu verit' (Подписанному верить)", *Kommersant*, 12 January 2006 (Accessed on the 26th August 2011, from EastView, Harvard Libraries); Alexandr Medvedev did the same in a teleconference on 16th January (See: "RosUkrEnergo to supply 17 bcm of RF gas in 2006", *Itar-Tass*, 16 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); Nikolaeva, Anna: "Nefeodal'nye otnosheniia (Нефеодальные отношения)", *Vedomosti*, 12 January 2006 (Accessed on the 3rd August 2011, from EastView, Harvard Libraries). However, as early as on 4th January, an article by *Ukrainska Pravda* echoed alleged "Gazprom"'s admissions regarding the inevitability of additional Central Asian gas into the "gas mix" as a way to reach the final price of US\$95 for Ukraine (See: Bondarenko, Dmitrii': "shcho stoit' za novitnimi "gazovimi tsiframi"?)", *Ukrainska Pravda*, 4 January 2006, at <http://www.pravda.com.ua/rus/articles/2006/01/4/4395606/> (Accessed on the 12th November 2012). Then, Aleksandr Medvedev on 16th January talked of the 17bcm of Russian natural gas being contracted for export to Europe through RosUkrEnergo (See: Grib, Natal'ia and Gavrish, Oleg: ""Naftogaz" zaplatit neizvestnym ("Нафтогаз" заплатит неизвестным)", *Kommersant*, 17 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

As opposed to gas transported from Central Asia sold to Ukraine, Gazprom could obtain a much better deal for Russian gas. This gas would be sold at the market price of \$230/tcm that the company had been fighting so hard for. RosUkrEnergo was suspected of selling it in Central Europe where it could extract a final price of US\$280/tcm and 50% of the final benefit would go directly to Gazprom.²⁶⁸ However, when it was finally confirmed that as opposed to what Russia had initially insisted, no Russian gas would be bought by Ukraine, the "victory" of having imposed market prices on Naftohaz stood in a very different light. The reason for that, as we now, is that this was done at the expense of increased Central Asian gas for Ukraine. Even if Gazprom after all "freed" important volumes of gas that were so far underpriced and linked to a very disadvantageous subsidization of the Ukrainian gas market, less Central Asian gas previously sold by Gazprom at market prices in Europe was made available as compensation.

Calculating Gazprom's financial losses and benefits for RosUkrEnergo

In order to know what were the financial consequences of the new composition of gas exported to Ukraine which eventually enabled Ukraine to do without (at least most of) Russian gas through the inclusion of more Turkmen (from around 24bcm before to 41bcm with the new agreement) and up to 15bcm of Uzbek and Kazakh gas, the new breakdown must be compared to the situation in the CIS and Europe before the deal to see how Gazprom's export policy was affected in terms of benefits. According to an assessment by Mikhail Korchemkin, *East European Gas Analysis*, the up to 15bcm of Kazakh and Uzbek gas to be contracted by RosUkrEnergo in 2006 for Ukrainian consumption had been so far exported by Gazprom in Europe and the CIS. Kazakh gas had been sold to the German company ZMB GmbH (Gazprom's subsidiary owned at 100%),²⁶⁹ to be exported to both Europe and CIS countries, 7 bcm for the Trans-Caucasus, 9bcm to Europe and 2 bcm to Moldova.²⁷⁰ Following this assessment, Kazakh gas would mostly be detracted from volumes exported to Europe by ZMB GmbH, whereas a reduction of volumes to be exported by Gazprom to Europe from 109bcm to 101bcm seems to roughly

²⁶⁸ The ownership of 50% of RosUkrEnergo was indirect: Gazprom owned Arosgas, the direct owner of half of the company, through an extremely obscure chain of subsidiaries that led to GazpromBank, subsidiary of Gazprom. Gazprom gained direct ownership of Arosgas after a lengthy process of purchase fulfilled only by late 2006 (Reznik, Irina: "RosUkrEnergo pereformili (RosUkrEnergo переоформили)", *Vedomosti*, 18 January 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁶⁹ ZMB GmbH was founded in 1993 as a subsidiary of "Gazprom Germania", a subsidiary itself of GazpromExport (see: Kupchinsky, Roman: "Gazprom's loyalists in Berlin and Brussels", *Eurasia Daily Monitor*, vol. 6, no. 100 (26 May 2009), at http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=35034 (Accessed on the 4th March 2013). The company was then merged with its mother firm Gazprom Germania on 8th August 2009 (See: "Verschmelzung der ZMB GmbH auf die GAZPROM Germania GmbH", Gazprom Germania (26 August 2009), at <http://www.gazprom-germania.de/presse/presseinformationen/pressemitteilung/article/verschmelzung-der-zmb-gmbh-auf-die-gazprom-germania-gmbh.html> (Accessed on the 4th March 2013).

²⁷⁰ Korchemkin, *op. cit.*

correspond to Uzbek volumes.²⁷¹ If the 17bcm of Russian gas that would be sold by RosUkrEnergo were then resold in Central Europe through Gazexport as the agreement specified, it would thus compensate for the Uzbek and Kazakh gas lost to the export markets.

However, in this scheme, Gazprom, though not by a wide margin, would see revenues sink. *East European Gas Analysis* assumed that under a selling price of US\$230tcm to RosUkrEnergo, the total earnings of Gazprom would sink from US\$19.141bill under the old agreements to US\$18.401bill now.²⁷² As it was assumed that the real selling price to RosUkrEnergo would be US\$170tcm instead, from US\$19.141bill to US\$18.197bill, Gazprom would most likely lose US\$945mill;²⁷³ If the assessment assuming US\$230tcm was considered, Gazprom would still lose US\$741mill. In April 2008 *Vedomosti* published a second version of how Ukraine's gas shares had been broken down in 2006. The article, which contained a table with both the volumes of all gas consumed in Ukraine and their origin from 1992 to 2007, registered 9.1bcm of Russian gas as having been consumed in Ukraine. The article also talks, which coincides to news by *Zerkalo Nedeli* (see below), of more than 9bcm left for RosUkrEnergo to export abroad in the rest of Europe (mainly Poland and Hungary). If true, this arguably meant that Ukraine had not consumed all Central Asian gas and a certain share of Russian gas instead. The figures in the table for Central Asian gas, totaling 47.8bcm roughly coincide with the volumes resulting from adding Turkmen and Uzbek gas priced at US\$65tcm which would then imply that Kazakh gas had not been consumed.²⁷⁴

Mikhail Korchemkin assumed that Kazakh gas needed to reach the final price of US\$95tcm for Ukraine; following his calculation, the average price of the Central Asian mix should have been US\$83, so it could be assumed that RosUkrEnergo was left a margin of US\$12tcm of benefits.²⁷⁵ Without Kazakh gas, US\$65tcm for Turkmen and Uzbek gas to which transport costs were added actually roughly matched US\$95tcm paid by Naftohaz, but counting in 9.1bcm of Russian gas priced at US\$230tcm makes the price of US\$95tcm impossible and indeed supports Korchemkin's assertion that cheap Kazakh gas priced US\$30tcm at the time was necessary for achieving the final price.

²⁷¹ See Table 1 in *Ibid.*

²⁷² *Ibid.* See alternative table at <http://www.eegas.com/images/archive/RUE230.PNG> (Accessed on the 6th October 2012).

²⁷³ Table 1 in *Ibid.* A later article in *Vremia Novosti* in September 2006 assumed a margin of US\$20-30tcm for RosUkrEnergo after the sale of Russian gas to Europe, so it seems warranted to assume the article was basing such a calculation on the price of US\$230 sold to RosUkrEnergo and something between \$250-60 resold by the latter to end-consumers in Europe (See: Grivach, Alexei: "Gazovyi' siurpriz dlia Kieva (Газовый сюрприз для Киева)", *Vremia Novosti*, 6 September 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

²⁷⁴ Reznik, Irina: "Analitika: Iamalorossii'skaia trgovlia (Аналитика: Ямалороссийская торговля)", *Vedomosti*, 1 April 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁷⁵ Korchemkin, *op. cit.*

Simon Pirani, writing in 2009, provides the following breakdown of gas volumes: 9.1bcm of Russian gas, 36.5bcm of Turkmen gas, only 2.8bcm of Uzbek gas and as much as 6.5bcm of Kazakh gas,²⁷⁶ nearly the maximum allowed under the 4th January 2006 agreement. This makes sense if we follow Korchemkin's assertion that Kazakh gas was needed to round up the price to reach US\$95tcm. Thus, the figure of 47.8bcm in *Vedomosti* would only coincidentally match the addition of Turkmen and Uzbek volumes of natural gas. Pirani also provides prices that differ with what Korchemkin indicated.²⁷⁷ According to him, Turkmen natural gas was priced at US\$65tcm and both Uzbek and Kazakh natural gas was priced at US\$50tcm.²⁷⁸ This assessment highly differs with the fact that Turkmenistan agreed with Gazprom on a price of US\$65tcm.

Incoherence regarding the US\$95tcm for Ukraine and the issue of costs for RosUkrEnergo

It should also be considered whether the price of US\$95tcm was real. The median price of gas for Ukraine in 2006 accepting the volumes given in *Vedomosti* would be around US\$118tcm, which is much beyond the US\$95tcm initially agreed.²⁷⁹ This figure is still doubtful, not only as Gazprom eventually recognized that no Russian gas would be sold in 2006 (which according to *Vedomosti* and Pirani (2009) only happened in 2007, when no Russian gas is registered in Ukraine's consumption), but no criticism was voiced in the following years, something which many from Timoshenko's Bloc would have denounced if it had finally implied higher prices.

One option could be that RosUkrEnergo had to assume the costs itself in order to maintain US\$95tcm for Ukraine. Therefore, maybe some of the benefits of selling natural gas abroad had to subsidise Ukraine's supply. Another option is that the price was real indeed, but the gas breakdown was not. Although Simon Pirani confirms the volume of 9.1bcm of Russian natural gas for Ukraine in 2009, in his report for The Oxford Institute for Energy Studies, "Ukraine's Gas Sector" from June 2007, while also reflecting the same figures, he nevertheless considered that part of 9,1bcm of Russian gas was counted

²⁷⁶ Pirani, "Ukraine: A gas dependent state", *op. cit.*, Table 3, p. 98.

²⁷⁷ Korchemkin, *op. cit.*

²⁷⁸ Pirani, "Ukraine: A gas dependent state", *op. cit.*, Table 3.2, p. 102.

²⁷⁹ Assuming the data on gas volumes by Pirani (*Ibid.*, Table 3, p. 98) and the pricing he offers (*Ibid.*, Table 3.2, p. 102), the median price would be US\$83.16tcm; with Korchemkin's prices for Central Asian natural gas, the price would be higher: US\$88.2tcm. Central Asian prices shown here are prices at these countries' border; if we add the US\$30tcm of transit costs usually assumed to the Ukrainian border, prices would be the following: Pirani: US\$108.18tcm / Korchemkin: US\$113.23tcm (*Author's own calculation*). As the reader can clearly see, this goes beyond US\$95tcm as agreed in 4th January 2006, the same way as with data provided by *Vedomosti*.

only physically and thus had no reflection on prices, with RosUkrEnergo probably assuming the costs instead of Naftohaz, if some Russian gas was finally sold in real terms.²⁸⁰

Gazprom's relations with gas traders in general and RosUkrEnergo in particular

Given the available information, it seems safe to assume that Gazprom did not make a profitable deal with the January 2006 agreement. However, that does not clarify suspicions that RosUkrEnergo was a strategic asset worth the apparent financial costs derived from the agreement.

Gazprom's treatment of favor to RosUkrEnergo

As Korchemkin himself mentioned some time later, financial reports stated that Gazprom had sold gas in 2005 to RosUkrEnergo instead of ZMB GmbH. In a letter to the *Financial Times*, the authoritative analyst stated that Gazprom had been selling gas during the first half of 2005 to RosUkrEnergo at US\$93tcm, and even less, US\$80, in the second half. This gas, later resold to Europe at US\$174tcm and then US\$205tcm in the second half, channeled huge profits to RosUkrEnergo at the expense of Gazprom who should have found it more advantageous to resort to ZMB GmbH.²⁸¹

Where did this gas come from? It must be remembered that under the agreement in July 2005 to solve the controversy regarding the 7.8bcm of "disappeared" gas, 5.25bcm of gas were sold to RosUkrEnergo; besides this, RosUkrEnergo earned 12-13bcm in concept for transit tariff, from which 5-6bcm were sold to Naftohaz, to be resold later to Central Europe (see p. 138). According to Gazprom's reports for the first 10 months of 2005, it had sold 15.538bcm of gas to RosUkrEnergo at prices ranging from US\$80tcm to US\$93tcm for Russian gas and US\$43tcm for Central Asian gas.²⁸² It true, this would mean that besides what RosUkrEnergo received in 2005, at least part of the natural gas thought to be sold to ZMB GmbH, as calculated by *East European Gas Analysis* in his March 2006 analysis, went through the trader.²⁸³

²⁸⁰ Pirani, "Ukraine's Gas Sector", *op. cit.*, p. 37, ft. 58.

²⁸¹ Korchemkin, Mikhail: "Why do shareholders ignore Gazprom's Swiss link?", Letter to the Financial Times, *East European Gas Analysis*, 20 July 2006, at <http://www.eegas.com/media/060720-FT.htm> (Accessed on the 20th November 2012); "Ukraine-Russia struggle to resolve dispute", *ICIS Heren*, 31 July 2006, at <http://www.icis.com/heren/articles/2006/07/31/9289270/ukraine-russia-struggle-to-resolve-dispute.html> (Accessed on the 20th November 2012); Korchemkin, Mikhail: "Eksport gaza: zlaboe sveno (экспорт газа: злабое звено)", *Vedomosti*, 17 July 2006 at http://www.pressmon.com/cgi-bin/press_view.cgi?id=1653502 (Accessed on the 28th November 2006 from Pressmon).

²⁸² Grivach, Alexei: "Zavtra, mozhет, opiat' voi'na (Завтра, может, опять война)", *Vremia Novostei*, 31 January 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

²⁸³ As Alla Eremenko and Iulia Mostovaia mentioned in an article in February 2008 in *Zerkalo Nedeli*, RosUkrEnergo would have exported 9bcm of gas in 2006 and 7bcm in 2007 (See: Eremenko, Alla and Mostovaia, Iuliia: "Poltsarstva - "Gazpromu" (Полцарства — «Газпрому»!)", *Zerkalo Nedeli*, 15 February 2008, at

Gazprom's treatment of favor to EuralTransGas

This preferential treatment was not new. Before RosUkrEnergo existed, EuralTransGas, which operated already in 2003 and had been granted permission by Gazprom to export Turkmen gas to Ukraine (see chapter 4, pp. 98-100), had allegedly served (as reported in 2004 already) as intermediary for gas sold to Gazprom's intermediaries in Germany (probably ZMB GmbH).²⁸⁴ If we assume that the same happened with RosUkrEnergo in 2005, this might be an explanation for the apparent contradiction between reports stating that gas had been sold to ZMB GmbH and reports which on the contrary pointed to RosUkrEnergo. In this case, we might state that losses incurred in the new agreement had already been incurred in 2005 under the previous conditions and that, voluntarily from the side of Gazprom.²⁸⁵

http://gazeta.zn.ua/POLITICS/poltsarstva_gazpromu.html (Accessed on the 15th October 2012); Vedomosti two months later in April 2008 mentions that RosUkrEnergo would be allowed to re-export above 9bcm of gas (see: Reznik, "Analitika", *op. cit.*). Eremenko and Mostovaia stated that RosUkrEnergo had declared these exports at prices of US\$95tcm in 2006 and US\$130tcm in 2007 to Ukrainian customs. This probably was a financial trick (these were the prices for the "Central Asian cocktail" and not Russian gas sold to the intermediary priced at US\$230tcm in 2006), unless Gazprom had managed from 2006 on, to establish an agreement similar as that established with EuralTransGas in 2004 (and possibly with RosUkrEnergo too in 2005), to sell its gas at reduced prices (RosUkrEnergo was probably forced in exchange to resell that natural gas to Gazprom's European filials at prices lower than market benchmarks).

In an article of March 2008, Alexei' Grivach refers to figures released by Naftohaz for hearings in the Rada, where there was talk of 11.6bcm gas transported to Europe by Gazprom (See: Grivach, Alexei': Ukraina snova v boi' (Украина снова в бой)", *Vremia Novosti*, 20 March 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries). Valentin Zemlianskii' from Naftogaz, mentioned a similar figure of 10.2bcm exported in 2007 (See: Grib, Natal'ia and Gavrish, Oleg: "Ukraina perekryla Rosukrenergo dostup v ES (Украина перекрыла Rosukrenergo доступ в ЕС)", *Kommersant*, 21 March 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries). *Vedomosti*, relying on sources from the trader itself, talked of 7bcm of annual export (See: Kashin, Vasili': "Gazovy' siurpriz (Газовый сюрприз)", *Vedomosti*, 21 March 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries);

A breakdown by *Neft Rossii* in late 2007 nearly confirms these following volumes sold in 2006 by RosUkrEnergo: 2.5bcm sold in Poland, 1.9bcm in Hungary, 3.5bcm in Slovakia and 0.8bcm in Rumania (See: "kto kormitsia ot "RosUkrEnergo" (Кто кормится от "РосУкрЭнерго"?), *Neft Rossii*, 16 October 2007 (Accessed on the 14th February 2013, from Integrum, Helsinki University Libraries).

²⁸⁴ Shlei'nov, Roman: "Rassledovaniia. Samykh bogatykh gotoviat na gaze (расследования. Самых богатых готовят на газе)", *Novaia Gazeta*, 21 August 2006 (Accessed on 27th August 2011, from East View, Harvard Libraries); Grib, Natal'ia and Butrin, Dmitrii': "Eksport gaza. Eural Trans Gas gotovitsia k prodazhe (Экспорт газа. Eural Trans Gas готовится к продаже)", *Kommersant*, 7 April 2004 (Accessed on the 18th August 2011, from East View, Harvard Libraries). It is also known that in 2007 GazExport entered into discussions with RosUkrEnergo to establish export cooperation (See: Gavrish, Oleg and Grib, Natal'ia: "'Gazprom' i RosUkrEnergo likvidiruiut konkurentsiiu ('Газпром' и RosUkrEnergo ликвидируют конкуренцию)", *Kommersant*, 27 June 2007.) and a debt by RosUkrEnergo amounting to US\$53 as of February 2008 to ZMB GmbH reported by *Kommersant* (See: Grib, Natal'ia: "Ukraina trebuet prava na e'ksport gaza", *Kommersant*, 18 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries), confirms that at least, some of the gas owned by the trader followed the pattern of previous schemes. It cannot however be ascertained whether such schemes were those possibly inherited from 2005, those successfully established in 2007 or maybe dating from early 2006. The whole debt to GazExport in quality of arrears and debt for Central Asian gas amounted to nearly \$1 mill, of which the debt to ZMB GmbH was but a small fraction (See: *Ibid.*). As ZMB GmbH, a former subsidiary of Gazprom Germania until 2009 (see: <https://www.gazprom-germania.de/en/company/profile/history.html>), had been the main end-supplier in 2005 for Central Asian gas (see: Korchemkin, "RosUkrEnergo", *op. cit.*), it is tempting to conclude that such a small debt responded to a reduced role of the subsidiary since RosUkrEnergo saw its role expanded.

²⁸⁵ See: Grib and Butrin, "Eksport gaza", *op. cit.* Purchases by RosUkrEnergo in 2005 might have followed a similar scheme.

Narratives regarding Gazprom's interests in gas traders

As for the reasons for Gazprom to support intermediaries, no authoritative answer can be easily found. However, two narratives exist.

One is linked to the political interpretations that were provided by many after details of the agreement started to be known (see above). According to this narrative, RosUkrEnergo was a strategic vehicle serving Gazprom's interests.

The other narrative is commonly followed by Gazprom itself, and portrays RosUkrEnergo more as a strategic buffer meant to assure Gazprom against risks. Following this latter narrative, one reason for Gazprom to forego some of its profits could have been to buttress the intermediary's financial situation as a buffer against payment problems from the Ukrainian side. In this respect we may consider EuralTransGaz's role earlier, as it had also exported Gazprom's gas to Western Europe in 2004. Clarifying, as far as it is possible, what was RosUkrEnergo's place in Gazprom's calculations can tell us much regarding whether Gazprom could be portrayed as a losing or a winning actor after the dispute.

The hypothesis of financial losses as an "investment" in political/corruption gains

In spite of gains like unlinked transit fees and gas prices, freed Russian gas from subsidized prices, a contract valid for five years where the transit tariff would remain unchanged and where prices would be periodically revised (that would enable Gazprom to force to assume periodic price increases from Central Asian producers) and the prohibition to Naftohaz to re-export gas, the financial analysis of gains, as calculated by Mikhail Korchemkin, shows Gazprom not only was a long way from being optimistic but even came out worse off than before the dispute: with Ukraine receiving more Central Asian gas (which was also moving to "market prices" but from a lower baseline),²⁸⁶ Gazprom ended up selling more Russian gas to Europe at the expense of Central Asian gas. Besides losing in financial terms, Gazprom could not fully enjoy its monopoly of Central Asian gas, which could not be exported at market prices to Europe while Ukraine consumed Russian gas at new market prices. However, the most important question was whether Gazprom gained politically from RosUkrEnergo.

²⁸⁶ As former Head of Naftohaz, Iurii' Boi'ko had stated back in June 2005 that Central Asian gas prices would increase following Russian gas price increases, and that indeed, was to happen in the next years. However, it was not until 2009 when they would finally reach market prices (See interview in: Eremenko, Alla: "Politicheskii' gazovyi' press (Политический газовый пресс)", *Zerkalo Nedeli*, 18 June 2005, at http://zn.ua/ECONOMICS/politicheskii_gazovyy_press-43696.html (Accessed on the 12th November 2012).

The nature of RosUkrEnergo

The Russian / Gazprom connection

Oleksandr Turchinov, Head of the Security Service (SBU) under Timoshenko's government, had stated back in June 2005 that RosUkrEnergo's approval could not have taken place without the approval of both the former Ukrainian government and Russia.²⁸⁷ Such a statement does not in itself clarify what the reasons for Russian approval were. A favorable narrative for Gazprom is that RosUkrEnergo, which was created as a result of the agreements between Russia and Ukraine on 29th July 2004 in substitution of EuralTransGaz,²⁸⁸ was approved by Gazprom because of misgivings with the latter,²⁸⁹ rather than having a direct interest in a deal which still created much opacity; RosUkrEnergo was probably not an improvement in itself, but an improvement in relation to EuralTransGaz, maybe not so much in terms of transparency, but mainly because Gazprom gained a participation of 50%.²⁹⁰

Russian interests regarding RosUkrEnergo

As seen in chapter 4, Russia had had a long relation with intermediary companies, that in the 90s worked as a buffer to guarantee gas exports from Central Asia by way of their better chances at liquidity,²⁹¹ a solution for constrained circumstances. This arrangements were nevertheless controversial and always prone to corruption; in the case of Itera, it served as a vehicle for the self-enrichment of Gazprom's directors at the time of Rem Viakhirev's leadership, in total opposition to the company's real business interests.²⁹²

²⁸⁷ "SBU probing colossal theft in gas business", *Kyiv Post*, 21 June 2005, at <http://www.kyivpost.com/content/business/sbu-probing-colossal-theft-in-gas-business.html?flavour=mobile> (Accessed on the 12th November 2012).

²⁸⁸ Fredholm, *op. cit.*

²⁸⁹ This was so either because of the bad publicity of the company, or because of Gazprom's frustration at relinquishing part of its market to a company in which it held no stakes (See: It's a gas: funny business games in the Turkmen-Ukraine gas trade", *Global Witness* (April 2006), p. 48, at http://www.globalwitness.org/sites/default/files/library/its_a_gas_april_2006_lowres.pdf).

²⁹⁰ This advantage is highlighted by Konstantin Chui'chenko, representative of Gazprom in RosUkrEnergo in the following article: "Chui'chenko, Konstantin: "Printsip krivogo zerkala (Принцип кривого зеркала)", *Vedomosti*, 10 August 2006 (Accessed on 18th August 2011, from East View, Harvard Libraries). The "scandal" surrounding EuralTransGas occurred when "Hermitage Capital" revealed the real composition of the company and made public the supposed losses incurred by Gazprom as a result of outsourcing to the intermediary company (See: Grib, Natal'ia: "Hermitage raskryl тайну Eural Trans Gas (Hermitage раскрыл тайну Eural Trans Gas)", *Kommersant*, 9 June 2004 (Accessed on the 7th January 2013 from Integrum, Helsinki University Libraries).

²⁹¹ Balmaceda, Margarita (2012): "Russia's central and eastern European energy transit corridor" in Aalto, Pami: *Russia's energy policies: national, interregional and global levels*, Edward Elgar, Cheltenham, UK, Northampton, USA, p. 145.

²⁹² *Ibid.*, pp. 44-46.

In the case of EuralTransGaz, the decision raised questions in 2003 as to whether Gazprom was just following the same patterns of corruption but with new actors, especially after Gazprom had promised to get rid of intermediaries.²⁹³ Gazprom asserted that EuralTransGaz would benefit both the Russian monopoly and its Ukrainian counterpart.²⁹⁴ Although sources from Naftohaz denied this and referred to the obscure trader as the strict competence of Gazprom,²⁹⁵ Iurii´ Boi´ko, at the time head of the Ukrainian company, would later talk of plans for Naftohaz and Gazprom to become 50% owners respectively of the trader.²⁹⁶

If eventually this did not happen, the emergence of RosUkrEnergo nevertheless reflected this project. The emergence of this new player was explained by Gazprom as a consequence of the latter's recovery of control of the pipeline "Central-Asia-Centre" planned for 2005.²⁹⁷

The importance of intermediaries in relation to Central Asian supplies should not be underestimated: RosUkrEnergo enabled Russia and Ukraine not to compete for supplies and thus play into the hands of Turkmenistan which started in late 2004 to demand higher prices.²⁹⁸ It could also, as explained by Gazprom, attract loans for upgrading the transport network in Central Asia for additional outlets.²⁹⁹ Explanations in this direction can be found in the two following examples:

Regarding the necessity of an intermediary, Alexandr Riazanov provided the following explanation in an interview in February 2009: "*It is a more transparent and fair structure than the former intermediary EuralTransGas. I think RosUkrEnergo earned its positive role, as Ukraine withheld payments. RosUkrEnergo acted as a buffer, in order not to fall under the Ukrainian legislation on taxes and customs duties.*"³⁰⁰

Much earlier than that, Konstantin Chui´chenko in an article to *Vedomosti* in August 2006, followed the same line writing that RosUkrEnergo had helped Gazprom recover a big part of the debt

²⁹³ Hermitage Capital had not found any link to personal figures within Gazprom when they reported the real composition of EuralTransGas (See: Grib, "Hermitage raskryl", *op. cit.*).

²⁹⁴ Reznik, Irina and Glubovich, Tat'iana: ""Itere" nashli zamenu ("Итере" нашли замену)", *Vedomosti*, 27 February 2003 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁹⁵ *Ibid.*

²⁹⁶ Grivach, Alexei': "Tranzit na dvoikh. "Gazprom" podelilsia s "Naftogazom Ukrainy" ot transportirovki gaza (Транзит на двоих. "Газпром" поделился "Нафтогазом Украины" доходами от транспортировки туркменского газа)", *Vremia Novosti*, 14 March 2003 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

²⁹⁷ Grib, Natal'ia and Glumskov, Dmitrii': "Gazprom" razvorachivaetsia na vostok ("Газпром" разворачивается на восток)", *Kommersant*, 21 December 2004 (Accessed on the 7th January 2013 from Integrum, Helsinki University Libraries).

²⁹⁸ In that respect, we may say that Turkmenistan nevertheless managed to impose its conditions.

²⁹⁹ See: Grib and Glumskov, "Gazprom" razvorachivaetsia", *op. cit.*; Grib, Natal'ia: "Interv'iu (Интервью)", *Kommersant*, 21 December 2004 (Accessed on 7th February 2013, from Integrum, Helsinki University Libraries)

³⁰⁰ Shevel'kova, Oksana: "posleslovie k voi´ne (Послесловие к войне)", *Vedomosti*, 2 February 2009, at <http://www.vedomosti.ru/smartmoney/article/2009/02/02/8908> (Accessed on the 21st November 2012).

accruing from the 7.8bcm of gas Naftohaz owed Gazprom, by buying the biggest part thereof and then reselling it to Europe.³⁰¹ Chui'chenko expanded in an interview to the journalist Natal'ia Grib, this time in the daily *Kommersant* in January 2007: he stated that a monopolistic intermediary in itself was needed to avoid competition between Ukraine and Russia in favor of Central Asian producers (mainly Turkmenistan)³⁰² and that regarding RosUkrEnergo in particular, not only did it represent Russian interests (which previous schemes did not) but was supposed to be able to expand the transportation infrastructure,³⁰³ while he also added (even if that was a reflection a posteriori), that RosUkrEnergo had proved its stability in three years in face of abrupt political changes in Ukraine.³⁰⁴

From the Ukrainian side, Iurii' Boi'ko, the actual father of RosUkrEnergo's enthronement in the Ukrainian market, put forward similar arguments in his interview for *Moskovskii' Komsomolets*, where he stated the necessity for contracting intermediaries given that they could allay animosity with and between Central Asian countries better than Naftohaz would by itself.³⁰⁵

Gazprom's contradictory position regarding RosUkrEnergo

It could perfectly be that Gazprom did not want to assume responsibility for a shady company thought to have links to corruption and delinquency and would not confess obscure reasons for supporting the intermediary. For example, regarding RosUkrEnergo's new expansion in the January 2006 agreement it was initially acknowledged that the initiative came from Russia. Indeed, declarations from the Russian Minister of Energy Viktor Khristenko confirming previous ones by the Ukrainian Prime Minister,³⁰⁶ who said Russia had taken the initiative of presenting RosUkrEnergo as a solution,³⁰⁷ seemed to support the thesis.

However, Gazprom soon started either downplaying its role as the sponsor of RosUkrEnergo, or voicing misgivings regarding its presence: Sergei' Kuprianov for example asserted that the arrangement involving both EuralTransGas and RosUkrEnergo had been the prerogative of the Ukrainian

³⁰¹ Chui'chenko, "Printsip krivogo", *op. cit.*

³⁰² Grib, Natal'ia: "'Struktura benefitsiarov RosUkrEnergo perezhila vseh politikov, kotorye stoiali u vlasti na Ukraine" ("Структура бенефициаров RosUkrEnergo пережила всех политиков, которые стояли у власти на Украине")", *Kommersant*, 22 January 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³⁰³ *Ibid.*

³⁰⁴ *Ibid.*

³⁰⁵ Dmitriev, "Ukraina pered", *op. cit.*

³⁰⁶ Dubnov, Vadim: "Noch' posle rozhdestva. Spor slabianochem-toprochem (Ночь после рождества. Спор славяночем-топрочем)", *Novoe Vremia*, 22 January 2006, p. 5 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

³⁰⁷ Kolesnikov, "Im prosto bylo", *op. cit.*

government.³⁰⁸ Khristenko also allegedly showed misgivings as to the real composition of RosUkrEnergo.³⁰⁹ The Russian Duma soon after the signature of the agreement (on 13th January 2006) sent a request to discover the real composition of RosUkrEnergo.³¹⁰ Gazprom's subsequent (and eventually successful) attempts to gain hold of Arosgas (real owner of 50% of RosUkrEnergo)³¹¹ that would ensue in the next months,³¹² could also be seen as a proof of Gazprom's tenuous influence on RosUkrEnergo. Gazprom's chairman of the board of directors (and future President of the Russian Federation from 2008 to 2012), Dmitrii' Medvedev, said that the optimal arrangement should rather involve Naftohaz and Gazprom³¹³ (something, by the way, reiterated some days later by Alexei' Miller,³¹⁴ and plainly acknowledged by Vladimir Putin himself in a press conference in Spain),³¹⁵ thus casting some doubts as to whether the Russian side was satisfied with the deal achieved. Alexei' Miller would later in February accuse the Ukrainian side for having allegedly rejected a direct contract, leaving them with no other alternative to expanding RosUkrEnergo's role.³¹⁶

³⁰⁸ Belton, Catherine: "Investigators in Kiev visit Naftogaz office", *Moscow Times*, 15 August 2005 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

³⁰⁹ Kolesnikov, "Podpisannomu", *op. cit.* At a press conference, he was ready to dismiss Reuter's correspondent's statement about Russian misgivings that would have been non-confidentially uttered (see: Kolesnikov, "Im prosto bylo", *op. cit.*).

³¹⁰ "Duma orders property committee to obtain info on RosUkrEnergo", *Itar-Tass*, 13 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); Reznik, Irina and Borisov, Nikolai': "Ch'i milliardy (Чьи миллиарды), *Vedomosti*, 16 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); "Iz dos'e "Slova". Ofshornaia firma dlia "umnykh" (Из досье "СЛОВА". ОФШОРНАЯ ФИРМА ДЛЯ "УМНЫХ")", *Slovo*, 20 January 2006 (Accessed on the 8th August 2011, from East View, Harvard Libraries).

³¹¹ See, Fredholm, *op. cit.*, pp. 22-23; "It's a gas", *op. cit.*, pp. 49; 51; Sergeev, Mikhail: "'Gazprom' perelozhil RosUkrEnergo" iz odnogo karmana v drugoi' ("ГАЗПРОМ" ПЕРЕЛОЖИЛ "РОСУКРЭНЕРГО" ИЗ ОДНОГО КАРМАНА В ДРУГОЙ)", *Gazeta*, 27 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); in fact, the same was tried from the side of "Naftogaz", if to believe Ivchenko's words, although in that case, unsuccessfully (see: Reznik and Borisov, "Ch'i", *op. cit.*; "Naftogaz Ukrainy seeks stake in shadowy gas trader", *Kyiv Post*, 19 January 2006, at <http://www.kyivpost.com/content/business/naftogaz-ukrainy-seeks-stake-in-shadowy-gas-trader-23707.html> (Accessed on the 13th November 2012); However, Ekhanurov was soon to deny that the Ukrainian state had any intention of entering into RosUkrEnergo's capital (Khvesik, Dmitrii': "Sobytiia. Fakty. Mneniia, tendentsii (СОБЫТИЯ. ФАКТЫ. МНЕНИЯ. ТЕНДЕНЦИИ)", *Gazeta*, 26 January 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

³¹² "Gazprom" would transfer the shares of Arosgas which hitherto belonged to the subsidiary of "GazpromBank" directly to the parent company (Natal'ia, Gavrish, "'Naftogaz" zaplatit", *op. cit.*; Belton, Catherine: "Miller and Medvedev talk of transparency", *Moscow Times*, 17 January 2006 (Accessed on the 30th August 2011, from East View, Harvard Libraries); Reznik, Irina; Simakov, Dmitrii' and Surzhenko, Vera: "Milliardy za prozrachnost' (Миллиарды за прозрачность), *Vedomosti*, 17 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries);

³¹³ Grivach, Aleksei': "Struktura imeet znachenie (Структура имеет значение)", *Vremia Novostei'*, 13 January 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

³¹⁴ Shatilova, Marina: "Gazprom to take direct part in RosUkrEnergo – Miller", *Itar-Tass*, 15 January 2006 (Accessed on the 23th August 2011, from East View, Harvard Libraries).

³¹⁵ Kolesnikov, Andrei': "Vladimir Putin vyskazalsia po ispanskomu krugu voprosov (Владимир Путин высказался по испанскому кругу вопросов), *Kommersant*, 8 February 2006 (Accessed on the 26th August 2011, from East View, Harvard Libraries); Grivach, Aleksei': "'Sprosite u Iushchenko" ("Спросите у Ющенко"), *Vremia Novostei'*, 8 February 2006 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

³¹⁶ "Izvestiia (ИЗВЕСТИЯ)", *Izvestiia*, 15 February 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

Did all these statements merely serve as devices for face-saving? This may be suspected as some other elements pointed at Gazprom's satisfaction: after Putin's sincerity at the Spanish press conference, the Ukrainian government jumped at the occasion and declared its intention to scrap the intermediary.³¹⁷ The Russian side on the contrary backtracked and closed this episode in a way which stood in severe contradiction with its previous statements: The Russian Minister of Energy, Viktor Khristenko refused to revisit the current agreements to avoid "creat(ing)extra difficulties for both sides" and thus postponed RosUkrEnergo's replacement for the moment when "there is another structure, understandable to the parties".³¹⁸ Gazprom did offer an alternative to Naftohaz, which consisted of the latter trying to gain the 50% of RosUkrEnergo (controlling the holding Centragas) which was controlled by Ukrainian interests. Naftohaz being financially unable to assume the costs involved, the matter was left to rest. This offer, and the lack of interest from Gazprom to change the status quo, could serve as a basis for the narrative of RosUkrEnergo as Gazprom's strategic vehicle.

Gazprom's eventual rejection of RosUkrEnergo

In the next year, occasional declarations from the Russian side went in the same direction its earlier declarations after the dispute as seen above: in March 2007 the new deputy chairman of Gazprom's management committee, Valerii Golubev hinted that RosUkrEnergo's arrangement was "not optimal" and Dmitrii Medvedev further suggested that in 2008 Gazprom would try to get rid of intermediaries (which eventually happened in 2009 after a new gas dispute).³¹⁹ This seemed to point to a good deal of dissatisfaction. The importance this time of such declarations is that they were to have a continuity as soon as a window of opportunity to remove RosUkrEnergo from the scene opened in 2008 and 2009, as we will see in the next two chapters.

In the light of the eventual agreement to wipe away RosUkrEnergo reached in March 2008 and executed after January 2009, Gazprom's initial reluctance to change the status quo after RosUkrEnergo's role had been expanded in January 2006 could in fact fit the company's narrative of the intermediary as a

³¹⁷ Grib, Natal'ia and Gavrish, Oleg: "Ukraina soglasna na "Gazprom" i gotova otkazat'sia ot RosUkrEnergo (Украина согласна на "Газпром" и готова отказаться от RosUkrEnergo)", *Kommersant*, 15 February 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries); Chai'ka, Fedor: "Ukraina prosit likvidirovat' "Rosukrenergo" (Украина просит ликвидировать "Росукрэнерго)", *Izvestiia*, 15 February 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries); Stetsiura, Raisa: "Ukraine offers rejection of RosUkrEnergo mediating services", *Itar-Tass*, 20 March 2006 (Accessed on 31st August 2011, from East View, Harvard Libraries); Solius, Maksim: "Tsitata nedeli (ЦИТАТА НЕДЕЛИ)", *Vedomosti*, 21 March 2006 (Accessed on the 20nd August 2011, from East View, Harvard Libraries).

³¹⁸ Lavrov, Andrei' and Potapov: "Minister objects to replacing intermediary in Russian gas supplies", *Itar-Tass*, 16 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); "Vektor (вектор)", *Vedomosti*, 20 February 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

³¹⁹ Fredholm, *op. cit.*, p. 29.

strategic buffer. A situation similar to that of weeks after the January 2006 agreement would happen around December 2007, when the second Timoshenko government was inaugurated (see next chapter), with Gazprom rejecting plans for revising the status quo, including RosUkrEnergo's suppression, if that also implied unfavorable economic conditions. However, when Gazprom could secure (at least relatively) favorable conditions, it did agree on the intermediary's suppression,

It is probable Gazprom had similar concerns back in 2006; it is interesting to consider Ekhanurov's declarations stating that in case of changing the intermediary, *documents should be revised* (emphasis mine)³²⁰, or that the compromise reached in January *could still be cancelled* (emphasis mine)³²¹ which Gazprom was most loath to accept. Timoshenko's policy after two years clearly exemplified what were the dangers for Gazprom of opening Pandora's box through the revision of current agreements, as the Prime Minister in her political comeback used RosUkrEnergo as an excuse for not honoring Ukrainian debts. It is safe to assume that Gazprom preferred not to negotiate any further changes in an agreement, which, as unsatisfactory as it might have looked in the beginning, was nevertheless positive in many aspects, if not for the benefits it secured, at least for avoiding more headaches in complicated energy relations with Ukraine.

The Ukrainian connection

Apart from doubts regarding Gazprom, it must be stated that the onus of proof was not placed exclusively on Gazprom. As investigations started by Turchinov in 2005 had revealed, there were obscure interests behind RosUkrEnergo, linked to corrupt schemes inherited from the Kuchma administration. The reason for the Timoshenko government focusing on this company was that it seemed to be a perfect example of the corrupt Ukraine the new Orange Revolution was supposed to reform. The fact that apart from Gazprom's role no one seemed to know who was behind the remaining half of the company, again caught everybody's attention when RosUkrEnergo came out reinforced from the January 2006 agreement. Initial suspicions were that these interests were linked to the former leadership and in that respect many speculated that these might be close to Gazprom too.

³²⁰ Krashakov, Alexei: "Ukraina pytaetsia izmenit' tseny na gaz putem otkaza ot RosUkrEnergo (Украина пытается изменить цены на газ путем отказа от RosUkrEnergo)", *Novaia Gazeta*, 15 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³²¹ Grib, Natal'ia and Gavrish, Oleg: "Ukraina pereotsenila gazovuiu litsenziu (Украина переоценила газовую лицензию)", *Kommersant*, 27 February 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

However, in a surprising move Timoshenko's government attempts at investigating the company were stopped by the President Yushchenko himself,³²² who was credited for protecting Dmitro Firtash, one of the main Ukrainian businessmen and later discovered to be the main owner of Centragas, the company that controlled 50% of RosUkrEnergo, along with Arosgas (owned by Gazprombank) and who was credited for having approached Yushchenko already on the eve of the 2004 elections. It seems thus warranted to speculate that the Ukrainian side might have had some interests in involving RosUkrEnergo in the new agreements and that Russia might have again followed as before their counterparts' initiative.³²³

RosUkrEnergo's true nature was disclosed by the daily *Izvestiia*, close to Gazprom's interests, possibly in order to forestall another scandal like that which happened with EuralTransGaz when its real owners were disclosed. *Zerkalo Nedeli* published a report based on internal information from RosUkrEnergo where its complicated composition was explained.³²⁴ Yushchenko's government apparent incapacity at finding information³²⁵ seemed inconsistent with rumours that linked the President with Dmitro Firtash. These rumours resurfaced when in early 2008, the Communist Party accused the President of having direct links to UkrGazEnergo through the company "PetroGas", headed by his own brother Petro Yushchenko,³²⁶ and would continue for years to come: in 2009, rumours surfaced which

³²² "Kto kormitsia ot "RosUkrEnergo", *op. cit.*

³²³ In this respect, we must consider reports about an alleged payment made by RosUkrEnergo, US\$53 mill to Dubai for the company PetroGas, linked to Petro Yushchenko (brother of the Ukrainian President) on 3rd January 2006, on the eve of the final agreement putting an end to the dispute (*Moskovskie Novosti* also refers to this episode, adding that the payment had been made just two hours before the agreement was signed, see: Kiselev, Sergei': "Oranzhevii' boomerang (оранжевий бумеранг)", *Moskovskie Novosti*, 27 January 2006 (Accessed on the 14th February 2013, from Integrum, Helsinki University Libraries). Another payment of US\$12,3 mill had also been made to the offshore company Refin (see: Gevorkian, Natalia: "Tselikom mutnaia istoriia (Целиком мутная история)", *Gazeta.ru*, 27 April 2006, at <http://wap.gazeta.ru/column/gevorkyan/626707.shtml> (Accessed on the 8th February 2013); this same article identified Refin as an Estonian company linked to Gazprom. However, information provided by *Vlasti* talked of 156mcm of Turkmen gas sold at US\$29tcm to this same Refin by Naftohaz. It must be highlighted that 215mcm of also Turkmen gas priced at a slightly lower price of US\$28tcm had been purchased by Naftohaz from PetroGas (Gazovyi' deriban, ili kak prezident Iushchenko bratishku podkarmlyval (Газовый дерибан, или Как Президент Ющенко братишку подкармливал)", *Vlasti*, 24 January 2006 (Accessed on the 14th February 2013, from Integrum, Helsinki University Libraries). Most reports by the way, point to Refin as a Oregon (USA) based company, which somehow seems to lead away from the Gazprom hypothesis.

³²⁴ Mostovaia, Iuliia: "O butonakh, tsvetochkakh i iagodkakh (О бутонах, цветочках и ягодах)", *Zerkalo Nedeli*, 21 January 2006, at http://zn.ua/ARCHIVE/o_butonah,_tsvetochkah_i_yagodkah-45715.html (Accessed on the 15th November 2012).

³²⁵ Stetsiura, Raisa: "Ukraine doesn't have enough info about RosUkrEnergo-Yushchenko", *Itar-Tass*, 14 March 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); Kolesnikov, Andrei': "Vybory na Ukraine. Revoliutsiia proshla proverku urnoi' (Выборы на Украине. Революция прошла проверку урной)", *Kommersant*, 27 March 2006 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

³²⁶ Grib, Natal'ia, Solov'ev, Vladimir and Gavrish, Oleg: "Viktora Iushchenko traviat gazom (Виктора Ющенко травят газом)", *Kommersant*, 16 January 2008 (Accessed on 14th February 2013, from Integrum, Helsinki University Libraries). Based in the United Arab Emirates, the company had won a tender for building an oil terminal in Turkmenistan valued at US\$25mill, and had received as well US\$50mill from RosUkrEnergo for other projects in that same country. No definitive factual proof could be found, but *Kommersant* suggested that PetroGas, which did not commercialize gas, could serve as a broker for gas owned by other companies (as for example UkrGazEnergo). Information from *Zerkalo Nedeli* in January 2006

accused Yushchenko of being the direct or indirect owner of 27% of RosUkrEnergo's shares.³²⁷ As *Kommersant* also informed, Yushchenko had been discovered to be one of the founders of the bank "Kliringovii' Dom", where Ivan Fursin (minor partner of Dmitro Firtash and owner of 10% of Centragas) owned 33%; the information had then been classified³²⁸ and other interesting personal connections can be found in the Syrian born Yussef Hares, a businessman linked to Firtash and politically close to the President himself.³²⁹ These recurrent rumours regarding the Ukrainian links of RosUkrEnergo give credit to the idea that beyond Gazprom, there were many interests in Ukraine, not only from the entourage of Yurii' Boi'ko, to protect the controversial intermediary.

The establishment of the JV UkrGazEnergo and Gazprom's interests

The last stage to fulfill the 4th January agreement was the establishment of a JV between RosUkrEnergo and Naftohaz to control the internal market of Ukraine. This gave credence to another interesting narrative in Ukraine, according to which the JV would be used by Gazprom to penetrate into the Ukrainian market and most importantly, bankrupt Naftohaz.

UkrGazEnergo would be owned by RosUkrEnergo and Naftohaz. The company was supposed to hold the monopoly within Ukraine to sell imported gas, with Gazprom thus having an indirect 25 % of this market. It is questionable whether this put Gazprom in a position with real prospects of gaining control of the internal Ukrainian gas market. Gazprom would indeed receive some benefits to round up a deal which in general involved financial losses, even if barely any details as for UkrGazEnergo's revenues transpired.

(see Eremenko, "Shalom gazavat", *op. cit.*) talked of a deal proposed by PetroGas and allegedly signed by Naftohaz in March 2005 for providing 215mcm of Turkmen gas at US\$28tcm. Rumours linking Yushchenko to RosUkrEnergo were already heard in early 2006 (See: Kanaev, Petr and Samsonov, Stepan: "Ukraina otorgaet "Gazprom" (Украина отторгает "Газпром")", *Gazeta*, 8 February 2006, at

http://www.gazeta.ru/2006/02/08/oa_187780.shtml (Accessed on the 14th February 2013) and "Gazovyi' deriban", *op. cit.* There were even reports by January 2009, which talked of Yushchenko's family as the real owners of 27% of RosUkrEnergo, earned through payments to offshore companies (see: Smith, Mike: "27% svoei' doli v "RosUkrEnergo" Iushchenko schitaet "voniuchei'" skhemoi' (27% своей доли в "РосУкрЭнерго" Ющенко считает "вонючей" схемой)", *Regnum* (through *Kompromat*), 13 January 2009 (Accessed on the 14th February 2013, from Integrum, Helsinki University Libraries). Before that, there were mentions of PetroGas as a shareholder of RosUkrEnergo (see: "Viktor Yushchenko i porosenok s dvumia penisami (Виктор Ющенко и поросенок с двумя пенисами)", *Vlasti*, 18 June 2007 (Accessed on the 14th February 2013, from Integrum, Helsinki University Libraries). Neither of these items could be confirmed. Iurii' Lutsenko, Minister of Internal Affairs in 2006, when the controversy exploded, denied the presence in the company of "those persons, who have been mentioned" (See his interview in: Mostovaia, Iulia and Butusov, Iurii', *Zerkalo Nedeli*, 23 February 2006 (Accessed on the 14th February 2013, from Integrum, Helsinki University Libraries).

³²⁷ Mentioned in: Kreslavskii', Vladimir: "Gaz poshel, voprosy ostaiutsia (GAZ POSHEL, VOPROSY OSTAIUTSIA)", *Moskovskaia Pravda*, 22 January 2009 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

³²⁸ Grib, Solov'ev and Gavrish, "Viktora Iushchenko traviat gazom", *op. cit.*

³²⁹ Kotliar, Eric: "Tai'ny Mogilevicha, iz-za kotorykh etogo muzhika zastavili maiat'sia v zastenke (Тайны Могилевича, из-за которых этого мужика заставили маяться в застенке)", *Moskovskaia Pravda*, 30 July 2008 (Accessed on the 14th February 2013, from Integrum, Helsinki University Libraries).

However, this can be linked to another narrative usually put forward in Ukraine, which is that the scheme involving RosUkrEnergo was devised as a means to gain control of the Ukrainian transportation network. According to Iuliia Mostovaia from *Zerkalo Nedeli*, once Ukraine was prohibited under the new agreement from selling either Russian or Turkmen gas, its subsidizing of gas might drive her to bankruptcy and force her to sell part of the network. Thus, the prohibition of Naftohaz re-exporting gas under conditions of the new agreement (article 2) which deprived the Ukrainian monopoly additional revenues, would have been intended to bankrupt Naftohaz from Gazprom so as to gain control of part of its assets could be related to and the fact that Naftohaz would have to share the market with RosUkrEnergo through UkrGazEnergo, thus splitting revenues.³³⁰

The justification for such a narrative is mostly based on the fact that, if Gazprom seemed to be losing in financial terms, Naftohaz did not gain either, with RosUkrEnergo being the real and indisputable winner as a result of this short dispute. Considering again the figures presented by Mikhail' Korchemkin, Naftohaz would lose US\$196mill from the new pricing and transit tariff, to which US\$50mill from sharing the internal market with RosUkrEnergo through UkrGazEnergo should be added. But in addition to US\$246mill lost, there had to be added losses from not being able to re-export gas to Central Europe any more.

6. 7. Epilogue: Negotiations on the Establishment of UkrGazEnergo

The 4th January agreement contained the seeds of future disagreements in some of its provisions: the periodic renegotiation of prices, the complete monopoly of an obscure intermediary, and the establishment for 1st February of UkrGazEnergo, the JV between RosUkrEnergo and Naftohaz for the distribution of imported gas in the Ukrainian gas market.³³¹ In fact, the rest of the month was to be mired in controversies as to how this JV would be constituted:

³³⁰ Mostovaia, "O butonakh", *op. cit.*; "Tekst soglasheniia", *op. cit.* See for example Peter Sevce's supposition, that Gazprom, through RosUkrEnergo's 50% ownership of the JV, could eventually gain shares of Ukrainian companies in the event of non-payment from their side (Sevce, Peter: "The role of intermediary companies in Russian-Ukrainian relations and implications for the countries of Central", *Despite Borders, Central and Eastern European Watch*, 11 January 2006, p. 5, at http://www.despiteborders.com/clanky/data/upimages/sprostredkovadelske_spolocnosti_ang.pdf (Accessed on the 21st January).

³³¹ Lutsenko, Igor': "Vii'na prodovzhuetsia (Війна продовжується)", *Ukrainska Pravda*, 7 January 2006, at <http://www.pravda.com.ua/rus/articles/2006/01/7/4395663/> (Accessed on the 6th November 2012).

Talks resumed on 13th January with the goal of setting up the JV by 20th January and signing a supply contract five days later.³³² But things proved more difficult and by 16th January, as opposed to initial intentions, nothing had been yet agreed. The Ukrainian side used the occasion to change the agreement and to bind Gazprom to a five- year supply contract to guarantee the price of US\$95tcm. This would force the Russian monopoly to assume further pricing changes from Central Asian suppliers (Turkmenistan actually was already hinting at higher prices between US\$80tcm and US\$85tcm) and thus subsidize the Ukrainian economy, whereas it was supposed that fixing the price would yield no benefits to RosUkrEnergo if the costs of Central Asian gas was_hiked beyond US\$70tcm.³³³ This being an impossible suggestion, neither talks on 18th January³³⁴ nor on 20th January³³⁵ were successful.

A new hurdle was that the Ukrainian Anti-Trust Commission did not give its permission for setting up the JV in the face of allegedly insufficient documentation from the side of Naftohaz and RosUkrEnergo.³³⁶ In the meantime, new items for confrontation, such as Russia's decision to stop imports of Ukrainian livestock products,³³⁷ accusations that Ukraine was again siphoning off gas in the midst of a cold spell³³⁸ with new effects on supplies to the rest of Europe,³³⁹ further marred bilateral relations in a still delicate moment. No agreement had been signed by the 25th January³⁴⁰ and negotiations continued until the very deadline, so the agreement opening the door for the constitution of the JV between

³³² "Ukraine, Russia to continue gas talks Friday", *Itar-Tass*, 13th January 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³³³ Sergeev, Mikhail: "Gazovoe peremiriie mezhdru Moskvoi' i Kievom mozhet prervat'sia (ГАЗОВОЕ ПЕРЕМИРИЕ МЕЖДУ МОСКВОЙ И КИЕВОМ МОЖЕТ ПРЕРВАТЬСЯ)", *Gazeta*, 16 January 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries); Grivach, Alexei': "Piatiletku za polgota (Пятилетку за полгода)", *Vremia Novostei'*, 16 January 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

³³⁴ Matarykin, Vitaly: "Gazprom, Ukraine Naftogaz readying draft natgas protocol", *Itar-Tass*, 18 January 2006 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

³³⁵ "Signing of Russia-Ukraine gas contracts postponed", *Itar-Tass*, 21 January 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³³⁶ Melnik, Mikhail: "Ukraine, Russia delay gas talks", *Itar-Tass*, 21 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³³⁷ Butrin, Dmitrii' and Shapovalov, Andrei': "Druzhba narodov (Дружба народов)", *Kommersant*, 23 January 2006 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

³³⁸ Grivach, Alexei': "Zakonno-nezakonnyi' otbor (Законно-незаконный отбор)", *Vremia Novostei'*, 24 January 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries); Alexandrova, Liudmila: "Ukraine taking away natural gas from freezing Europe", *Itar-Tass*, 24 January 2006 (Accessed on the 30th August 2011, from East View, Harvard Libraries); Rzhnevsky, Valery: "Ukraine tapping extra Russian gas", *Itar-Tass*, 24 January 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); Snegirev, Aleksei': "To est' podvorovyvaiut... (То есть подворовывают...)", *Trud*, 25 January 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries); "Gazprom accuses Ukraine of siphoning nat gas bound for Europe", *Itar-Tass*, 26 January 2006 (Accessed on the 30th August 2011, from East View, Harvard Libraries); Melnik, Mikhail: "Naftogaz admits Ukraine exceeds Russia gas siphoning off in Jan", *Itar-Tass*, 26 January 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³³⁹ Nikolaeva, Evgeniia: "Evropa merznet iz-za Ukrainy (Европа мерзнет из-за Украины)", *Isvestiia*, 26 January 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

³⁴⁰ "Naftogaz Ukrainy, RosUkrEnergo discuss JV's gas sale functions", *Itar-Tass*, 25 January 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries); Melnik, Mikhail: "Premier hopes JV to be set up Wednesday, Naftogaz Ukrainy is not sure", *Itar-Tass*, 25 January 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

Naftohaz and RosUkrEnergo could not happen. According to Konstantin Chui'chenko, Head of Gazprom's Juridical Department and Co-Executive Director of RosUkrEnergo, disagreements existed as Naftohaz wanted to see its subsidiary Gaz Ukrainy enter the JV, whereas RosUkrEnergo itself preferred Naftohaz.³⁴¹ The main agreement was possible only when the Ukrainian Anti-Monopoly finally gave its approval on 31st January:³⁴²

UkrGazEnergo was formed with equal shares by Naftohaz and RosUkrEnergo and would only start selling to the internal Ukrainian market from 1st March. More significant than this one-month delay was that instead of the 32bcm of imports initially planned, it would be allowed to sell only 5.4bcm of gas per year (that for a license valid for five years).³⁴³ With the creation of the new company, the energy dispute was finally over a month after the final agreement was signed, which had put an end to cut-offs. As for Ukraine's pretension to fix the price of US\$95bcm as agreed on the 4th January and provisionally valid for at least the first month before the constitution of the JV, there was a certain confusion: as opposed to what Naftohaz wanted, Gazprom only had agreed in principle to keep the price of US\$95bcm until 1st July 2006,³⁴⁴ otherwise RosUkrEnergo would suffer losses if supplies from Central Asia became more expensive.³⁴⁵ RosUkrEnergo Executive Director Chui'chenko was explicit when he stated that prices would have to move if Central Asian suppliers increased prices,³⁴⁶ something which matched Gazprom's statement that the contract would be the object of renegotiation in the event of "changes independent of the parties" (read, suppliers' new prices).³⁴⁷

³⁴¹ "Sobytiia (СОБЫТИЯ)", *Vedomosti*, 26 January 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

³⁴² Melnik, Mikhail: "Naftogaz, RosUkrEnergo to continue talks on JV Thursday", *Itar-Tass*, 1st February 2006 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

³⁴³ Melnik, Mikhail: "UkrGaz-Energo gets five-year license for supplying of 5 bcm of gas", *Itar-Tass*, 9 March 2006 (Accessed on the 30th August 2011, from East View, Harvard Libraries); Grivach, Alexei': "Sjurpriz dlia "Gazproma" (Сюрприз для "Газпрома")", *Vremia Novostei'*, 10 March 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

³⁴⁴ Reznik, Irina; Bekker Aleksandr and Kashin, Vasilii: "Bestsennyi' gaz (Бесценный газ)", *Vedomosti*, 3 February 2006 (Accessed on 18th August 2011, from East View, Harvard Libraries).

³⁴⁵ It was suspected at the time that prices might move at the middle of the year from US\$95 to US\$115 (See: Iudina, Lyudmila: "Vot vam posrednik (Вот вам посредник)", *Trud*, 4 February 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

³⁴⁶ Matarykin, Vitaly: "Gas price for Ukraine depends on Russian, Turkmen prices", *Itar-Tass*, 3 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³⁴⁷ Grivach, Alexei': "Predpriiatie nedomolvok (Предприятие недомолвок)", *Vremia Novostei'*, 3 February 2006 (Accessed on 19th August 2011, from East View, Harvard Libraries); Reznik, Irina and Kashin, Vasilii': "'Gazprom" nazval tsenu ("Газпром" назвал цену)", *Vedomosti*, 6 February 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

6. 8. Preliminary Conclusions

The preliminary conclusions we may extract from the January 2006 energy dispute is that it's being a victory for Gazprom remains an arguable interpretation. Many interpretations, as seen above, saw it as a defeat outright, while from the Ukrainian side, interpretations tended to differ radically, putting Ukraine as the loser in this dispute. The problem of the agreement reached is probably the fact that there are elements for considering the dispute's outcome as both a defeat for Gazprom and Naftohaz; both clearly lost in financial terms, with the latter arguably ending up worse off. As we have seen, the obscurity of RosUkrEnergo's allegiance makes difficult to consider whether Gazprom obtained gains from the trader's expanded role. We may advance here that elements point to either a limited defeat for Gazprom for the sake of saving face and putting a stop to a dispute that went out of hand or at least a compromise, short in any case of the initial objectives.

The year 2005 was beyond any doubt a year where the situation changed for Russia in what regards energy issues with Ukraine. The starting point for Russia probably was the decision by the Ukrainian side to reconsider the current agreements in its favor, raising the transit tariff. Russia jumped into the occasion to demand higher prices too, and try to make Ukraine converge with the upward trend in oil prices, which were pushing up natural gas prices in Europe. The attempts at revision from the Ukrainian side came in a context of increasing energy subsidies for Ukraine, in comparative terms, as oil prices increased, and along with them, natural gas prices sold at market prices beyond the FSU countries. In addition, the clash between Putin's Russia and the new Orange leadership in Kiev arguably made these subsidies more unpalatable. If not enough, there was a clear competition between Russia and Ukraine during 2005 to obtain favourable pricing conditions from Central Asia and in the case of Gazprom, to reinforce its monopsony and suppress direct relations between Ukraine and Turkmenistan. These changes offer a possible explanation for Russia to have forced Ukraine to accept a set of conditions (higher prices) which eventually led Russia to stop gas supplies in the face of Ukraine's negative.

Once these conditions, in a lesser or bigger degree led to the energy dispute of January 2006, the sequence of events, reflecting a process of escalation, were the following: on 1st January, Gazprom stopped supplies to Ukraine; as both supplies for Ukraine and the rest of European consumers depending on Ukraine as transit country flow together, Gazprom simply reduced volumes according to Ukraine's consumption. However, Ukraine escalated the dispute when it started disrupting the flow of natural gas and provoked that a bilateral energy dispute translated into an energy crisis in Central Europe, as supplies started falling. If we may trust press reports, it seems that Naftohaz siphoned off more natural gas than

justified for sheer technical needs. Once Ukraine had taken this step, Gazprom decided to deescalate the dispute, taking the decision on late 2nd January, made effective the next day, of restoring normal supplies. Negotiations continued during that day and in early 4th January the agreement was reached.

Why did Gazprom deescalate the dispute? The obvious answer of the Russian side having reached its goals, as we have had the opportunity to see in the pages above, when the agreement was analyzed, cannot be sustained. In the best of cases, Gazprom and the Russian government above preferred a compromise, where even financial losses were assumed, while complete control of Central Asian resources could not be achieved, whereas the added value of RosUkrEnergo for Gazprom is not obvious, especially in sight of its suppression, as we will see in chapter 8, after the January 2009 dispute. This assessment, which will be taken up anew in chapter 9, opens the door for using prospect theory to interpret Russian decision's in the dispute.

Russia seemed to behave as a classical risk-averting actor, likely not wanting to assume further reputational damages caused by the a dispute which was affecting from the very first day most dependent consumers in Central Europe. A prospect theory based interpretation would fit with Russia's behavior as a risk-avert actor, not willing to assume further risks for the sake of winning the energy dispute it had started with Ukraine. Thus, assuming a compromise, or even a losing agreement for the sake of preserving the elements of the status quo with which Gazprom and the Russian government were arguably satisfied, would have been the most reasonable move.

Our conclusions in chapter 11 will devote more space to determine the potentiality of this explanation, as well as to determine which were the economic and political factors that influenced and what was their relation between each other.

Chapter 7: Russia-Ukraine Energy Dispute of March 2008

7. 1. New Tremors from Central Asia in 2006 and the Complex Triangle between Russia, Turkmenistan and Ukraine

As we saw in the previous chapter, Russia and Ukraine had put an end to their energy dispute in January 2006 with the signature of an agreement on 4th January 2006. That agreement expanded the role of RosUkrEnergo and made Ukraine totally dependent on Central Asian gas. This meant that Ukraine would henceforth be even more dependent on Turkmenistan's energy policy at a moment when the Central Asian republic insisted on higher prices for its gas. The agreement subscribed by Russia with Turkmenistan (see previous chapter, p. 157), secured for the former an amount of 30bcm of gas priced at US\$65tcm. It was thus supposed that at least for the first months of 2006, Ukraine, through the intermediation of RosUkrEnergo, would be dependent on the agreements reached by Russia and Turkmenistan.¹ In fact, when negotiations were still continuing on how the JV of Naftohaz and RosUkrEnergo, the future UkrGazEnergo, would be established, parallel negotiations were taking place between Russia and Turkmenistan. Turkmenistan was trying again to raise prices.

Russia seemed to be interested in managing that prices would also go up for Ukraine,² as it needed Ukraine to absorb the increase. Turkmenistan initially sought prices ranging between US\$80tcm and US\$85tcm.³ However, Ashgabat soon proposed US\$100tcm instead, to be effective by the end of the year.⁴ In this context, Russian and Ukrainian interests went in hand, as both needed to contain Turkmenistan's ambitions. This is why Alexei Miller's delegation in February was accompanied by that of his Ukrainian equivalent, Ivan Plachkov. The tandem was unfortunately not very effective, as the

¹ As we could see in the previous chapter, some confusion reigned at the beginning regarding the two contradictory agreements Turkmenistan had signed with both Russia and Ukraine (see previous chapter, p. 158), with most of the gas suspected of being sold directly to Naftohaz and only a fraction sold to Gazprom (see previous chapter). The fact is that, as seen below, Ukraine became fully dependent on Gazprom's contracts with Central Asian republics from the very beginning of January 2006.

² Zygar', Mikhail and Grib, Natal'ia: "Protivostoianie. Turkmenbashi vziali v torg (Противостояние. Туркменбаши взяли в торг)", *Kommersant*, 23 January 2006 (Accessed on the 26th August 2011, from East View, Harvard Libraries); Butrin, Dmitrii: "Turkmeniia predpochitaet torgovat'sia (Туркмения предпочитает торговаться)", *Kommersant*, 24 January 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

³ Zygar' and Grib, "Protivostoianie", *op. cit.*; Belton, Catherine: "Gazprom on the march in Ukraine", *The Moscow Times*, 7 February 2006 (Accessed on the 30th August 2011, from East View, Harvard Libraries). Meanwhile, a Ukrainian delegation also present in Moscow, aimed in vain at contracting for Naftohaz volumes of gas for US\$50tcm in the first half of the year, and US\$60tcm for the second (See: Butrin, "Turkmeniia predpochitaet", *op. cit.*). This went in the line with Ivan Plachkov's previous declarations, where he insisted he had secured an agreement with Ashgabat for 22bcm of gas for US\$50 and 20bcm for US\$60, all agreed with RosUkrEnergo (See, Zygar' and Grib: "Protivostoianie", *op. cit.*). At the time, as Dmitrii Butrin mentioned, neither Turkmenistan confirmed this nor could Ukraine explain what it had offered in exchange to reach such a deal when the Central Asian republic was precisely aiming at much higher prices.

⁴ Grivach, Alexei: "Turkmenskaia sotnia (Туркменская сотня)", *Vremia Novostei*, 13 February 2006 (Accessed on the 23th August 2011, from East View, Harvard Libraries).

Ukrainian delegation had neither margin of decision nor credibility; Plachkov's delegation met with a harsh rebuke from their Turkmen counterparts when reminded about the outstanding debt, now amounting to US\$159mill.⁵ Sergei' Ivchenko, Naftohaz's head, retaliated declaring that Ukraine would have to stop imports of Turkmen gas if prices were to be increased.⁶ That was a threat that sounded void due to Ukraine's dependence on Turkmen gas.⁷

Turkmenistan led Ukraine to believe that a direct agreement was still possible. It may be suspected that Ashgabat's goal was to entice Kiev to pay its debts. Thus in March there was talk of an agreement to sell gas to Ukraine at a price of US\$60tcm (US\$10tcm more than US\$50tcm as agreed in the frustrated agreement before the gas dispute, but still less than US\$65tcm agreed with Gazprom)⁸, as long as Ukraine paid back US\$59.6mill (leaving US\$28.7mill for later) out of its outstanding debt in cash, while the debt corresponding to the barter payment was reduced from US\$67.3mill to US\$12.2mill through the sale of steel pipes.⁹

However, Turkmenistan persisted in its mistrust of Ukraine, of whose solvency it publicly doubted; the postponement of the Ukrainian Prime Minister's visit from March to May, which soured mutual relations, was a reaction to the Turkmen attitude.¹⁰ The Ukrainian side complained that Turkmenistan refused to discount from the debt US\$88mill that had been paid in January for Turkmen gas that never ended up being supplied,¹¹ since direct supplies between Turkmenistan and Ukraine were terminated and all gas sold to GazExport instead.¹² Thus, statements by President Yushchenko back to February hoping for prices of US\$60tcm, dwelt in the realm of wishful thinking. Neither could Ukraine really believe Prime Minister Ekhanurov's declaration saying that prospective prices of US\$100tcm for Turkmen gas would not affect end prices for Ukrainian consumers,¹³ (the government had recently

⁵ Kurbanova, Anna: "Ukrainian gas debt to Turkmenistan nears \$159 million – Niyazov", *Itar-Tass*, 19 February 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁶ Melnik, Mikhail: "Ukraine to stop gas supplies from Turkmenistan if it raises price", *Itar-Tass*, 21 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁷ See: Grivach, Alexei': "Zagazovannyi' den' rozhdeniia Turkmenbashi (Загазованный день рождения Туркменбаши)", *Vremia Novostei'*, 20 February 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

⁸ Grib, Natal'ia and Gavrish, Oleg: "Ukraina pereotsenila gazovuiu litsenziu (Украина переоценила газовую лицензию)", *Kommersant*, 27 February 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

⁹ "Bez kommentariiev (БЕЗ КОММЕНТАРИЕВ)", *Vremia Novostei'*, 13 March 2006 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

¹⁰ Kurbanova, Anna: "Turkmenistan doubts about Ukraine's solvency", *Itar-Tass*, 19 March 2009 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

¹¹ Grivach, Alexei': "Avansovaia diskussiiia (Авансовая дискуссия)", *Vremia Novostei'*, 21 March 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹² Grivach, Alexei': "Dolgovaia truba (Долговая труба)", *Vremia Novostei'*, 20 March 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹³ Grib and Gavrish, "Ukraina pereotsenila", *op. cit.*

decided to cap prices for gas sold by UkrGazEnergo at US\$110)¹⁴, irrespective of further increases from suppliers.

The permanent character of the framework approved in January was confirmed in June 2006: all of Turkmen gas in the first half of the year, around 21bcm, had been sold to RosUkrEnergo by Gazprom in accordance with the latest agreement in December when the Russian monopoly purchased 30bcm of Turkmen gas.¹⁵ According to *Vedomosti*, despite having signed in January an agreement with Ukraine to sell 40bcm, priced at US\$44tcm for the first half of 2006, to be increased to US\$60tcm for the second half, Turkmenistan remained faithful to the other agreement signed with Gazprom but at the more favorable price of US\$66tcm (an additional US\$1tcm had been added).¹⁶ In June 2006 Naftohaz's marginalization was sealed when Gazprom announced the sale of the remaining 20bcm of gas for consumption in Ukraine to Gazexport. In addition to that, Ashgabat was to propose that Gazprom should set a price for a yearly supply of 50bcm of gas for the period 2006-08 (the amount was unrealistic, as owing to the real transit capacity of the "Central Asia-Center" pipeline, hardly more than 41-42bcm could be transported).¹⁷ The Ukrainian side belatedly proposed now a price of US\$65tcm,¹⁸ but, as seen above, Turkmenistan was targeting much higher prices around US\$100tcm and Gazprom aimed at a compromise between US\$80tcm to US\$85tcm.¹⁹ Naftohaz was out of the game and Gazprom faced tough negotiations.

Miller's June visit to Turkmenistan failed to reach a satisfactory agreement for the second half of the year. Gazprom insisted on a price of US\$65tcm but Turkmenistan did not move from its goal of US\$100tcm.²⁰ If Gazprom refused to budge, Turkmenistan responded with even higher figures: taking advantage of alleged Kazakh plans to sell gas at US\$150tcm, Ashgabat now wanted prices between US\$110-125tcm.²¹ This spiral raised concern in Ukraine, the end consumer of all this Turkmen gas. Following Valerii Nesterov from *"Troika Dialog"*, final prices could end up amounting to US\$140tcm-

¹⁴ Matarykin, Vitaly: "Ukraine permits Urganaz-Energo to sell gas at price not over \$110", *Itar-Tass*, 8 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁵ Grivach, Alexei: "'My dogovorimsia' ('Мы договоримся')", *Vremia Novostei*, 16 June 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹⁶ Bekker, Alexandr, Reznik, Irina: "Turkmeniia prosit dvoit'nuiu tsenu (Туркмения просит двойную цену)", *Vedomosti*, 20 June 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁷ Grib, Natal'ia and Gavrish, Oleg: "'Gazprom' lishit Ukrainu turkmenskogo gaza ('Газпром' лишит Украину туркменского газа)", *Kommersant*, 16 June 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

¹⁸ *Ibid.*

¹⁹ Grivach, "My dogovorimsia", *op. cit.*

²⁰ Grib, Natal'ia: "'Gazprom' poluchil udar po tsenam ('Газпром' получил удар по ценам)", *Kommersant*, 22 June 2006 (Accessed on 22nd August 2011, from East View, Harvard Libraries); Grivach, Alexei: "Prai's-list ot Turkmenbashi (Прайс-лист от Туркменбаши)", *Vremia Novostei*, 22 June 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

²¹ Bekker and Reznik, "Turkmeniia prosit", *op. cit.*

US\$150tcm,²² which, according to *Vremia Novostei*, would be US\$130tcm at the border if Turkmenistan went back to US\$100tcm.²³ Compared to the current prices of US\$95tcm, this represented 50% more. Attempts by Yushchenko, who personally called Turkmen President Niyazov and proposed a direct sale of an additional 11bcm for the second half of the year, were useless. The Turkmen president simply insisted on negotiations with Gazprom, which as transit country was the necessary interlocutor,²⁴ and dismissed the Ukrainian partner reminding him of the debt of US\$63mill still due.²⁵ According to sources from the Turkmen Ministry of Energy, Turkmenistan would be ready to sell 11bcm directly to Ukraine only in the event of a previous agreement by Naftohaz with Gazprom and the rest of transit countries. Besides this, Turkmenistan reminded him it would not sell gas cheaper than US\$100tcm.²⁶

The impossibility of reaching an agreement between Russia and Turkmenistan led to such acrimony that the latter went as far as to declare the cancelation of all previous agreements with Gazprom after a new visit by Miller showed a staunch rejection of Turkmen conditions.²⁷ Given Turkmenistan's threats to stop supplies to Russia, Ukraine tried to outsmart Gazprom and tried to buy that additional 11bcm Yushchenko had been lobbying for recently;²⁸ Ukraine was again confronted with US\$100tcm.²⁹ Nevertheless, Gazprom decided to involve Ukraine in negotiations³⁰ and profited to revive the old idea of a transport consortium: Gazprom would facilitate gas transit if Ukraine granted a participation in the

²² *Ibid.*

²³ Grivach, "Prai's list", *op. cit.*. Nesterov's assessment, bearing in mind that transportation costs were usually calculated as a maximum at US\$30tcm, was concerned necessarily with a scenario of US\$100tcm, arguably the real price Turkmenistan was aiming at. *Vedomosti*, echoing the words of Riazanov, who referred to prices Ukraine would eventually have to face in the upcoming season of Fall and Winter, made another calculation of US\$150-160tcm as the end price for Ukraine, relying again on a selling price of US\$100tcm; however, in the light of other calculations and of the transit costs, it was more realistic to attribute such a price in case Turkmenistan managed to impose US\$110-125tcm and not US\$100tcm (see: Reznik, Irina; Bekker, Alexandr and Kashin, Vasilii: "Turkmeniia davit na gaz (Туркмения давит на газ)", *Vedomosti*, 22 June 2006 (Accessed on the 20th August 2011, from East View, Harvard Libraries); Veletminskii, Igor: "Obmen tsenami (Обмен ценами)", *Rossii'skaia Gazeta*, 22 June 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

²⁴ *Ibid.*

²⁵ Bekker and Reznik, "Turkmeniia prosit", *op. cit.*

²⁶ Reznik, Bekker and Kashin, "Turkmeniia davit", *op. cit.*

²⁷ Grib, Natal'ia: "'Gazpromu' otkryli vostochnyi' front ('Газпрому' открыли восточный фронт)", *Kommersant*, 30 June 2006 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

²⁸ Grivach, Alexei: "Ne otstupat' i togovat'sia (Не отступать и торговаться)", *Vremia Novostei*, 30 June 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁹ Rzhnevskii, Valery: "Turkmenistan wants to review gas agreement with Ukraine", *Itar-Tass*, 30 June 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³⁰ The article by Ianina Vas'kovskaia at *Novaia Gazeta* voices two different opinions: one states that Russia was sincerely interested in preventing Turkmen price increases and thus formed a natural front with Ukraine, whereas the other thought on the contrary, that Turkmen price increases would help Russia by justifying its own pricing policy (See: Vos'kovskaia, Ianina: "Ianukovich ne smozhet igrat' na trube (янукович не сможет играть на трубе)", *Novaia Gazeta*, 21 August 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

Ukrainian pipeline network (GTS).³¹ The Ukrainian side agreed in principle³² and both countries established a common front against Turkmenistan. Gazprom ensured that prices for the third quarter of the year (other news sources talked of a promise for the rest of the year)³³ would remain at US\$95tcm.³⁴ This new spirit of cooperation led Gazprom to show some flexibility regarding the existing debt Naftohaz was accumulating with RosUkrEnergo and other problems regarding gas in storage facilities for the upcoming winter.³⁵ However, negotiations remained deadlocked during most of the summer and uncertainty persisted as to which prices Ukraine would have to pay by late 2006.

7. 2. The New Relation between Naftohaz and RosUkrEnergo and Derived Problems

While both Gazprom and Naftohaz had to face the threat of ever changing Turkmen energy policies, problems were already originating from the complex scheme stemming from the 4th January agreements.

Ukraine tries to revise agreements and guarantee stable prices

The main controversy centered on the validity of the price of US\$95tcm. Naftohaz wanted to fix that price for five years, which was in fact the period of duration of the agreement, whereas Gazprom obviously wanted to determine the price depending on prices established by Central Asian suppliers. Naftohaz thus took the decision to cap prices at US\$110tcm, so RosUkrEnergo could never sell gas beyond that price.³⁶ Whether this was meant to guarantee acceptable prices for Ukraine at the expense of Gazprom or RosUkrEnergo, or whether this was part of a policy to put pressure on Gazprom, could not be ascertained. However, when the Ukrainian Minister of Economy, Arseny Yatseniuk, warned against *those* (emphasis mine) aiming at bankrupting the Ukrainian economy,³⁷ he was expressing Ukrainian suspicions as to Gazprom's real intentions.

³¹ Grib, Natal'ia and Gavrish, Oleg: "'Gazprom' snova otpravil Ukrainu k Turkmenbashi ('Газпром' снова отправил Украину к Туркменбашу)", *Kommersant*, 7 July 2006 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

³² Grivach, Alexei': "'Radovat'sia nuzhno' ('Радоваться нужно')", *Vremia Novostei*, 7 July 2006 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

³³ Grib, Natal'ia; Chernovalov, Alexandr and Gavrish, Oleg: "Ukraina gotova otdat' 'Gazpromu' truboprovody (Украина готова отдать 'Газпрому' трубопроводы)", *Kommersant*, 14 July 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

³⁴ Kezik, Irina: "V 'Gazprom' zhduť Timoshenko (В 'ГАЗПРОМЕ' ЖДУТ ТИМОШЕНКО)", *Gazeta*, 7 July 2006 (Accessed on 19th August 2011, from East View, Harvard Libraries).

³⁵ Sergeev, Mikhail: "Diad'ka iz Kiev (ДЯДЬКА ИЗ КИЕВА)", *Gazeta*, 18 July 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

³⁶ Matarykin, "Ukraine permits", *op. cit.*

³⁷ *Ibid.*

The fact is that the Ukrainian economy was having troubles already to absorb the latest price increases, so unfavorable compared to US\$44tcm (Turkmen gas) and US\$50tcm (Russian gas obtained as payment of transit tariffs). That easily raised suspicions in Ukraine that US\$95tcm were "political" prices meant by Gazprom to punish the Orange Revolution and/or to bankrupt the country to eventually penetrate into its market.

Naftohaz's opposition to RosUkrEnergo and UkrGazEnergo

Naftohaz's next moves targeted RosUkrEnergo and UkrGazEnergo directly.

RosUkrEnergo

At least rhetorical declarations from the Russian side in favor of seeing Naftohaz become 50% owner of the controversial trader (See previous chapter, pp. 180-182), spurred the Ukrainian side to propose to scrap RosUkrEnergo outright. This, Prime Minister Ekhanurov did when he sent a letter to the Russian Minister of Economics, Mikhail Fradkov.³⁸

In parallel with this initiative, President Yushchenko ordered his government to obtain as much information as possible on the mysterious ownership of Centragas, which constituted half of RosUkrEnergo (besides Arosgas, owned by Gazprom Bank).³⁹ The price increases that Turkmenistan was seeking at that moment were an additional reason for Ukraine to scrap RosUkrEnergo, which as an intermediary, was seen as spurious at best.⁴⁰ Naftohaz's (somewhat cynical) argumentation was that since prices had been fixed at US\$95tcm for the next five years (which in fact was Naftohaz's wishful interpretation), any increase would automatically destroy RosUkrEnergo's profits and make its presence useless. A JV between Naftohaz and Gazprom to manage transportation was thus found more suitable.⁴¹

The Russian response was to reject the Ukrainian proposal.⁴² Instead, Gazprom again encouraged Naftohaz to take control of that other half of the intermediary. This was an option hardly acceptable for

³⁸ Grib, Natal'ia and Gavrish, Oleg: "Ukraina soglasna na "Gazprom" i gotova otkazat'sia ot Rosukrenergo (Украина согласна на "Газпром" и готова отказаться от Rosukrenergo)", *Kommersant*, 15 February 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries);

³⁹ *Ibid.*; Rzhetskii, Valery: "Ukraine security service to check operation of gas company", 17 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁴⁰ Krashakov, Alexei: "Ukraina pytaetsia izmenit' tseny na gaz putem otkaza ot RosUkrEnergo (Украина пытается изменить цены на газ путем отказа от RosUkrEnergo)", *Novaia Gazeta*, 15 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁴¹ Reznik, Irina and Kashin, Vasilii: "Rosukrenergo ne nuzhna Ukraine (Rosukrenergo не нужна Украине)", *Vedomosti*, 15 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁴² Lavrov, Andrei and Potapov, Andrei: "Minister objects to replacing intermediary in Russian gas supplies", *Itar-Tass*, 16 February 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

Naftohaz for mere financial reasons, especially when the value of the company had skyrocketed as a result of its improved position after the January agreement. The Russian side did not provide any financial help to Naftohaz. The request for a common JV was reiterated later in March, through National Security and Defense Council Secretary, Anatoly Kinakh,⁴³ but to no avail.

UkrGazEnergo

In the face of the Russian refusal to change the status quo, Naftohaz turned to the other controversial company, UkrGazEnergo. Expected to start operating at the beginning of March, the government was still casting doubt on whether it would become operative at all. Iurii Ekhanurov demanded that the company provide banking guarantees to the value of US\$300mill and complained that such a demand had not been fulfilled.⁴⁴ The Ukrainian government demanded from Gazprom that it cover US\$75 of this sum (equivalent to the quarter that indirectly corresponded to the Russian gas monopoly). Gazprom plainly refused, alleging that enough guarantees had been already provided.⁴⁵

Then in an attempt to nullify the company's role, the NKRE decided to restrict its sales in the Ukrainian internal market to only 5.4bcm (see previous chapter, p. 188).⁴⁶ That would allow Naftohaz to retain the biggest part of the lucrative market of private companies, now in the hands of UkrGazEnergo. In addition to that, it was decided that UkrGazEnergo would pay value added taxes (VAT) equivalent to 20% of the value of the selling price, which would dent the company's competitiveness (Naftohaz paid no such taxes).⁴⁷ In a more drastic move, the Industrial Federation of the Donbass went to the tribunals to cancel the agreements that had led to higher internal prices,⁴⁸ moving in fact from US\$80tcm to US\$115tcm.⁴⁹

⁴³ Stetsiura, Raisa: "Ukraine offers rejection of RosUkrEnergo mediating services", 20 March 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁴⁴ Grib and Gavrish, "Ukraina pereotsenila", *op. cit.*

⁴⁵ *Ibid.*

⁴⁶ Grivach, Alexei: "Siuipriz dlia "Gazproma" (Сюрприз для "Газпрома")", *Vremia Novostei*, 10 March 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries); this decision was eventually cancelled (See: Grivach, Alexei: "Odnogo zhelaniia malo (Одного желания мало)", *Vremia Novostei*, 17 August 2006 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

⁴⁷ Grib, Natalia and Gavrish, Oleg: ""Gazprom" oblozhili dopolnitel'nymi nalogami na vnutrennem rynke Ukrainy ("Газпром" обложили дополнительными налогами на внутреннем рынке Украины)", *Kommersant*, 13 March 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

⁴⁸ Gavrish, Oleg and Grib, Natal'ia: "Gazovaia kontrataka. Donbass trebuet rastorgnut' sdelku s "Gazpromom" (Газовая контрактация. Донбасс требует расторгнуть сделку с "Газпромом")", *Kommersant*, 11 April 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

⁴⁹ Borisov, Nikolai and Reznik, Irina: "Energoresursy. Sliskom dorogo (Энергоресурсы. Слишком дорого)", *Vedomosti*, 12 April 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

Naftohaz's indebtedness problems

Since new prices were agreed in January 2006, Naftohaz started indebting itself towards RosUkrEnergo, leading to the classical debt spirals. This led RosUkrEnergo to warn Naftohaz of a 50% supply reduction starting on 10th April as a result of non-payments.⁵⁰ RosUkrEnergo also said it was ready to extract half of the gas from underground storage facilities (equivalent to its share as 50% owner of UkrGazEnergo) and sell it at any moment to Europe. According to the Director of the Center of Energy Research in Kiev, Konstantin Borodin and as stated by *Vremia Novostei* too, the debt amounted to US\$700mill.⁵¹ As reported by *Zerkalo Nedeli* at the end of the following month, the debt amounted by April 2006 to less than that, US\$400mill, but had jumped to US\$900mill by the time of the publishing of the article one month later.⁵²

Naftohaz insisted on the figure of US\$400 mill, whereas Gazprom (indirectly affected as 50% owner of RosUkrEnergo) calculated that the debt hovered at US\$500mill-US\$600mill and had to be repaid before May's end (in correspondence between Naftohaz and the government, discovered by *Zerkalo Nedeli*, the exact figure provided was US\$581.9mill as of 8 of June).⁵³ Naftohaz responded blaming Gazprom for not having paid transportation services as the reason for the debt. The Russian monopoly obviously rejected this accusation.⁵⁴ Gazprom's spokesman Sergei Kuprianov clarified that these debts were not debts owed directly to the company, with which Naftohaz had no direct relations anymore, but to RosUkrEnergo.⁵⁵ Gazprom, as Alexandr Riazanov explained, was affected due to its partial ownership of the intermediary.⁵⁶

One of the explanations for the origin of this new debt is that it had accumulated in January and February due to insufficient payments to Naftohaz from its industrial consumers. It appeared that

⁵⁰ Grivach, Alexei: "Kiev snova ne platit (Киев снова не платит)", *Vremia Novostei*, 14 April 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

⁵¹ Grivach, Alexei: "Delo na 700 millionov (Дело на 700 миллионов)", *Vremia Novostei*, 17 April 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

⁵² Mostovaia, Iuliia: "Osada zamknutogo kruga (Осада замкнутого круга)", *Zerkalo Nedeli*, 20 May 2006, at http://zn.ua/ARCHIVE/osada_zamknutogo_krug-a-46754.html (Accessed on the 4th November 2012).

⁵³ Eremenko, Alla: "'Naftogaz' – Kambinu: 'Dai' milliard! Dai' miliard! («Нафтогаз» — Кабмину: «Даймиллиард!»)", *Zerkalo Nedeli*, 24 June 2006, at http://zn.ua/ARCHIVE/naftogaz_kabminu_day_milliard_day_milliard-47081.html (Accessed on the 27th November 2012).

⁵⁴ "Vchera (Вчера)", *Kommersant*, 23 May 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

⁵⁵ "Ukraine Naftogaz not in debt to Gazprom - Russian co spokesman", *Itar-Tass*, 21 May 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

⁵⁶ Eremenko, Alla: "Otkuda u 'Naftogazu' dolgi pered RosUkrEnergo i chem grozit obernut'sia nesgovorchivost' 'Gazprom' (Откуда у «Нафтогазу» долги перед RosUkrEnergo и чем грозит обернуться несговорчивость «Газпрома»)", *Zerkalo Nedeli*, 10 June 2006, at

http://zn.ua/ARCHIVE/otkuda_u_naftogazu_dolgi_pered_rosukrenergo_i_chem_grozit_obernutsya_nesgovorchivost_gazprom-a-46960.html (Accessed on the 27th November 2012).

Naftohaz had not duly prepared documentation for the NKRE so prices had not been updated on time; payments made under older (and cheaper) tariffs necessarily created a deficit.⁵⁷ In addition to this debt, new difficulties for Naftohaz stemmed from Deutsche Bank's restrictions for its financing, the prohibition of reselling gas to Europe and as some voices argued, mismanagement inherited from the government of Timoshenko that left the company financially weak.⁵⁸

As an immediate solution, it was known that Naftohaz would request a loan of US\$400mill to repay the debt.⁵⁹ It was later clarified that it would ask for US\$300mill, to which US\$200mill already requested to the ABN Amro Bank had to be added.⁶⁰ Pending the resolution of the debt issue, it was discovered in late May that RosUkrEnergo, true to its previous warning, had stopped shipments to Naftohaz since the beginning of May. Instead, RosUkrEnergo bypassed the Ukrainian monopoly and sold all of its gas to UkrGazEnergo directly.⁶¹ At the same time, UkrGazEnergo, which started operating in April 2006,⁶² asked Naftohaz to pay in advance for needed supplies.⁶³ Otherwise, it refused to provide any supplies.⁶⁴ When contracts were finally signed between Naftohaz and UkrGazEnergo, it transpired that the former was also indebted to the latter (US\$25.5mill).⁶⁵ At such stage, it was not clear whether this debt to UkrGazEnergo was also part of the debt to RosUkrEnergo. Mr. Riazanov declared that he wished that the debt of US\$370mill would be reduced to US\$100mill before the 1st of July,⁶⁶ whereas the new Head of

⁵⁷ Grivach, "Delo na 700 millionov", *op. cit.* As later acknowledged by Naftohaz, this, along with the impossibility of obtaining enough loans, was the main reason (see: Eremenko, "Naftogaz" – Kambinu", *op. cit.*).

⁵⁸ For this latest version, see for example: Grivach, Alexei: "V kosmos ne letat'! (В космос не летать!)", *Vremia Novostei*, 20 April 2006 (Accessed on 18th August 2011, from East View, Harvard Libraries).

⁵⁹ Matarykin, Vitaly: "Naftogaz Ukrainy to take 400-mln-dollar loan to pay off gas debts", *Itar-Tass*, 24 May 2006 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁶⁰ "Vkrattse (вкратце)", *Vedomosti*, 15 June 2006 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁶¹ Grivach, Alexei: "Predpriiatie osobogo naznacheniiia (Предприятие особого назначения)", *Vremia Novostei*, 31 May 2006 (Accessed on the 17th August 2011, from East View, Harvard Libraries); it begs the question whether the fact that RosUkrEnergo started selling integrally to UkrGazEnergo, which as it seems (see fn. below), only started operating in April (by then, according to Simon Pirani, it had contracted 17bcm of gas to a series of industrial customers (see: Pirani, Simon: "Ukraine's gas sector", Oxford Institute for Energy Studies (June 2007), p. 61, at <http://www.oxfordenergy.org/pdfs/NG21.pdf> (Accessed on the 5th November 2013), was not the logical consequence of the January agreement, which foresaw UkrGazEnergo as the company responsible for marketing within Ukraine imported gas, instead of a measure of retaliation. The fact that it was not clear what were the exact proportions of gas marketed by Naftohaz and UkrGazEnergo, at least in the first months, makes it difficult to clarify this issue.

⁶² The company had been established in March, but it seems that for whatever reasons, it only managed to start operating one month later. This could be related to its restrictions at selling about 5bcm only and that most of the gas contracted for March went through Naftohaz.

⁶³ Naftohaz was henceforth only responsible for the regulated market. Naftohaz would sell cheap domestic gas to residential consumers and it would also provide gas to district heating companies. This latter category was supplied with a mix of domestic gas, the same as with residential consumers, and imported gas (see: Pirani, "Ukraine's gas sector", *op. cit.*, pp. 54, 64. Since the emergence of UkrGazEnergo, imported gas for district heating companies had to purchase from UkrGazEnergo.

⁶⁴ Eremenko, "Naftogaz" – Kambinu", *op. cit.*

⁶⁵ *Ibid.*

⁶⁶ "Chego vy zhдете ot nedeli? (Чего вы ждете от недели?)", *Kommersant*, 26 June 2006 (Accessed on 24th August 2011, from East View, Harvard Libraries).

Naftohaz substituting Alexei Ivchenko, Alexandr Bolkisev, promised to solve the debt problem before the end of August.⁶⁷

Stored gas controversy

Besides the debt problem, a transitory new controversy arose with gas stored in Ukraine for the winter.⁶⁸ This new controversy somehow was a reminder that regarding 7.8bcm of "disappeared" gas one a year before.⁶⁹ According to calculations by *Zerkalo Nedeli*, due to unspecified limitations of the system, no more than 16.5bcm of gas could be pumped after June,⁷⁰ compared to 18-24bcm that had been pumped in last year.⁷¹ Naftohaz argued that 4.6bcm had already been stored before June,⁷² so a sufficient volume could be guaranteed. However, (contradictory) figures were not very reassuring. According again to *Zerkalo Nedeli*, 4.8bcm was the amount of gas that was planned to be pumped during the period April-October, barely more than the meager 4.6bcm, which according to Naftohaz, had been pumped already. This represented a striking difference with the year before, when Naftohaz had pumped 13bcm of Ukrainian gas in the same period.⁷³ According to Mr. Riazanov, the real volume of gas stored was 3.6bcm, therefore, 15bcm to 16bcm had to be supplied before October to reach the usual volumes.⁷⁴ In order to avoid such problems in the future, Gazprom now demanded to be either sold or granted in form of rental three of the storage facilities and refused at the same time Naftohaz's decision to raise from 10 to 30 hryvnia (US\$6bcm) the price charged for using these deposits.⁷⁵ In fact it seemed that this was the main disagreement which explained why pumping of Russian gas had not been carried out as scheduled.⁷⁶

⁶⁷ Teter, Ekaterina: "'Naftogaz' pogasit zadolzhennost' pered Rossiei' do sentiabria ('Нафтогаз' погасит задолженность перед Россией до сентября)", *Gazeta*, 14 July 2006 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁶⁸ This stemmed from a complex scheme of sales between Naftohaz and Gazprom derived from the fact that since Soviet times, sizable storage facilities had been concentrated in the Western part of Ukraine. The reason for this was the following: during the summer, when demand for gas was low, these facilities were filled up. When the peaks of consumption arrived in winter and whenever the capacity of pipelines through Ukraine was filled to its maximum due to consumption to both Ukraine and foreign customers, volumes stored could be released from the border of the Soviet Union and added through outgoing flows, owing to the additional capacity of pipelines. This system guaranteed that demand could be always covered. Since the fall of the Soviet Union, the physical reality remained the same, but not the institutional. Henceforth, Naftohaz filled the storage facilities in summer from gas bought to Gazprom and whenever needed in winter, Gazprom could count on part of this gas for its use. Since that part of the gas was the property of Naftohaz, it was swapped for other direct shipments from Gazprom.

⁶⁹ "Grib, Natal'ia and Gavrish, Oleg: "'Gazprom' predlozhit Ukraine ne smeshivat' gaz ('Газпром' предложил Украине не смешивать газ)", *Kommersant*, 2 June 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

⁷⁰ Eremenko, "Otkuda u 'Naftogazu'", *op. cit.*

⁷¹ Grib and Gavrish, "'Gazprom' predlozhit", *op. cit.*

⁷² Eremenko, "Otkuda u 'Naftogazu'", *op. cit.*

⁷³ Eremenko, "Naftogaz" – Kambinu", *op. cit.*

⁷⁴ "Chego vy zhдете", *op. cit.*

⁷⁵ This increase in tariff would affect Gazprom indirectly through natural gas belonging to RosUkrEnergo.

⁷⁶ Grib and Gavrish, "'Gazprom' predlozhit", *op. cit.*

RosUkrEnergo stepped in to ensure that in case Naftohaz could not fulfill its obligations it would pump in any gas necessary to maintain uninterrupted supply of gas to Europe.⁷⁷ Soon however, an agreement was announced with UkrGazEnergo, where the latter pledged to pump 16.3bcm as needed (in fact this meant that half would be coming from Naftohaz and the other half from RosUkrEnergo)⁷⁸. Added to 4.8 pumped by Ukraine and all the technical gas, this would amount to a total of 23bcm of gas.⁷⁹

RosUkrEnergo's ownership and the role of Ukrainian private interests

While both negotiations with Turkmenistan and problems with UkrGazEnergo piled up, one of the big mysteries of RosUkrEnergo was disclosed in April: the real owners of Centragas, the holding which controlled 50% of the company, were revealed. These happened to be the businessmen Dmytro Firtash and Ivan Fursin, both Ukrainian citizens. After vain efforts from the Ukrainian side during 2005 to disclose RosUkrEnergo's ownership and in the face of Russian assurances that they did not have information beyond the fact that it represented Ukrainian interests, the obscure company revealed its true nature.

The trigger seems to have been an investigation by the US secret services, which concerned by the potential dangers to energy security, were trying to discover the identity of the controversial trader. This happened at the same time when Russia informed how the Russian Ministry of Foreign Affairs and the security services of the FSB had been unable to find out further information. The Russian side claimed the identity was protected by Swiss legislation and by Raiffeisen Investment itself.⁸⁰ The Russian Duma asked the Office of the General Attorney to demand from Gazprom copies of the agreement/s signed in January.⁸¹

According to the *Wall Street Journal*, while US secret services started investigating the composition of RosUkrEnergo,⁸² a thorough report by the British NGO *Global Witness*, specialized in

⁷⁷ Khvesik, Dmitrii: "RosUkrEnergo mozhет spasti Ukrainu (RosUkrEnergo может спасти Украину)", *Gazeta*, 21 June 2006 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

⁷⁸ "Vektor (вектор)", *Vedomosti*, 19 July 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

⁷⁹ "Ukraina nashla gaz dlia PKhG (Украина нашла газ для ПХГ)", *Kommersant*, 26 June 2006 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁸⁰ Grib, Natal'ia and Gavrish, Oleg: "RosUkrEnergo ne raskrylas' FSB (RosUkrEnergo не раскрылась ФСБ)", *Kommersant*, 14 April 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁸¹ "Sobstvenniki RosUkrEnergo: prozrachny do nevidimosti (Собственники RosUkrEnergo: прозрачны до невидимости)", *Zerkalo Nedeli*, 15 April 2006, at

http://zn.ua/POLITICS/sobstvenniki_rosukrenergo_prozrachny_do_nevidimosti-46508.html (Accessed on the 25th November 2012); Kilichev, Alexei: "Temnoe delo (ТЕМНОЕ ДЕЛО)", *Novye Izvestiia*, 18 April 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁸² Belton, Catherine: "Gas firm under U.S. scrutiny", *Itar-Tass*, 24 April 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); Simonenko, Alexandra and Sidorov, Dmitrii: "Rassledovanie. RosUkrEnergo popala pod vneshnee

corruption in the energy and mining field, published an article devoted to the Turkmen-Ukrainian relations and the history of trading services offered by intermediaries.⁸³ Among the flow of new data that the NGO offered, the name of Dmytro Firtash surfaced as one of the businessmen behind the founding of EuralTransGaz (see chapter 4).⁸⁴ However, neither the NGO nor US secret services needed to delve much deeper for the truth on RosUkrEnergo to be revealed: on 26th April, the Russian daily *Izvestiia*, partly owned by Gazprom,⁸⁵ disclosed the real ownership. Apart from identifying the two businessmen of Centragas, the article indicated that they held 90% (Dmytro Firtash) and 10% (Ivan Fursin). They were thus indirect owners of 45% and 5% of RosUkrEnergo respectively.⁸⁶ Ivan Fursin, the minor partner, was known to be linked to Serhiy´ Levochkin, ex-aide of former President Leonid Kuchma,⁸⁷ whereas Dmytro Firtash, who as seen above, had played an important role in EuralTransGaz, was very well known in Ukraine among elite circles.⁸⁸ The article based its information on an audit undertaken by Pricewaterhouse Coopers.⁸⁹ Raiffeisen Investments from its side, declared one day after the publication that after two to three months, it would disclose the identity of owners (which was not necessary anymore) and then withdraw from RosUkrEnergo as trustee of the 50% under discussion.⁹⁰

It seems fully justified to wonder whether *Izvestiia* did not take advantage of its relation with Gazprom to disclose RosUkrEnergo's ownership. In that case, the main question is to consider why Gazprom had withheld the information for so long and then decided precisely now to make it public. It seemed reasonable to proceed this way as Firtash's role would be known sooner or later, since US secret services were actively involved. Thus the longer Gazprom withheld the information, the more harmful

nabliudenie (Расследование. RosUkrEnergo попала под внешнее наблюдение)", *Kommersant*, 24 April 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); Sergeev, Mikhail: "SShA vstupili v gazovuiu voi'nu s Rossiei' (США ВСТУПИЛИ В ГАЗОВУЮ ВОЙНУ С РОССИЕЙ)", *Gazeta*, 24 April 2006 (Accessed on the 31th August 2011, from East View, Harvard Libraries); Simpson, Glen R. and Crawford, David: "U.S. investigates critical supplier of gas to Ukraine; Europe's energy security is at heart of concerns; opaque ownership queried", *The World Street Journal*, 21 April 2006 (Accessed on the 25th November 2012, from ProQuest, Complutense Libraries).

⁸³ Global Witness: "It's a gas. Funny business in the Turkmen-Ukraine gas trade" (April 2006), at <http://www.globalwitness.org/library/its-gas-funny-business-turkmen-ukraine-gas-trade> (Accessed on the 25th November 2012).

⁸⁴ *Ibid.*

⁸⁵ The daily *Izvestiia* did not belong to Gazprom proper, but to its subsidiary GazpromBank, owner itself of Arosgas (which owned 50% of RosUkrEnergo) (see: Stepanenko, Svetlana and Grivach, Alexei: "Kto igraet na trube (Кто играет на трубе)", *Vremia Novostei*, 27 April 2006 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

⁸⁶ Berezhnoi', Vladimir: "Kto vladeet ukrainskim gazom. "Izvestiia" stali izvestnyime natainstvennykh benefitsiariev ukrainskoi' poloviny kompanii "Rosukrenergo": Firtash - 90%, Fursin - 10% (Кто владеет украинским газом. "Известиям" стали известными натаинственных бенефициариев украинской половины компании "Росукрэнегро": Фирташ - 90%, Фурсин - 10%)", *Izvestiia*, 26 April 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁸⁷ Mostovaia, Iuliia: "Gazovaia Firtashka (ГАЗОВАЯ ФИРТАШКА)", *Zerkalo Nedeli*, 29 April 2006, at http://zn.ua/ARCHIVE/gazovaya_firtashka-46657.html (Accessed on the 26th November 2012).

⁸⁸ *Ibid.*

⁸⁹ Berezhnoi', "Kto vladeet", *op. cit.*

⁹⁰ Kidenis, Alexandr: "Gaz rasseialsia, tuman ostalsia (газ рассеялся, туман остался)", *Russkii' Kurier*, 1 May 2006 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

this could be to its interests. Konstantin Chui'chenko himself in an interview to *Kommersant* in early 2007 acknowledged that the audit had taken place before determining the contracts of 2006 (in 2005 Pricewaterhouse Coopers substituted KPMG as the official auditor of RosUkrEnergo) and had accepted the role of the two private investors, even if they were in principle interested in seeing Naftohaz instead.⁹¹ This probably dispelled allegations at the time that Pricewaterhouse Coopers was not at the origin of the information,⁹² and that news about the real composition of RUE came "*in the past 10 days or so*".⁹³ Gazprom therefore, knew of Centragas' true nature since a long time.

Did the Ukrainian side have the same information that Gazprom had? With Naftohaz not involved in RosUkrEnergo, it could be argued that it was more difficult for the Ukrainian government to find out. However, the presence in Naftohaz of a person like Ihor' Voronin, closely linked to Iurii' Boi'ko, former Head of Naftohaz and who had represented RosUkrEnergo in the agreements of July 2004, is a justified ground for suspicion. Efforts to disclose the ownership of Centragas from the side of Ekhanurov's government were likely to be stymied by a President who had allegedly opposed the SBU investigations at the time of Timoshenko's government. Even worse, if we are to believe Alexandr Riazanov's words to *Vedomosti* (as reported by Iuliia Mostovaia's article in *Zerkalo Nedeli*), none other than Firtash himself attended meetings representing Naftohaz to discuss conditions for gas supplies in 2006.⁹⁴ He was also said to have been present in late April 2006 in Naftohaz's headquarters (Naftohaz insisted that Firtash did not work with the new leadership in the company).⁹⁵ If that was the case, Naftohaz's duplicity was obvious. The entourage of the President only reacted with skepticism upon the information, waiting until "*further documentation supporting this assertion could be found*".⁹⁶ Dmytro Firtash himself claimed to have concealed his own identity in order both "*to win the business with Russian gas monopoly OAO Gazprom and to avoid political pressure in Ukraine*". Indeed, according to the *Wall Street Journal*, Firtash was introduced to Gazprom only as technical expert by Raiffeisen's Wolfgang Putschek.⁹⁷

Regarding doubts about the trustworthiness of both Russia's and Ukraine's efforts to disclose information, Mr. Herbert Stepic from Raiffeisen Investment stated that the ownership was known to both

⁹¹ Grib, Natal'ia: ""Struktura benefitsiarov Rosukrenergo perezhila vseh politikov, kotorye stoiali u vlasti na Ukraine" ("Структура бенефициаров Rosukrenergo пережила всех политиков, которые стояли у власти на Украине")", *Kommersant*, 22 January 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁹² Shlei'nov, Roman: "Ne nado, my sami (не надо, мы сами)", *Novaia Gazeta*, 27 April 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁹³ White, Gregory L.; Crawford, David and Simpson, Glenn R.: "At Gazprom partner, key investor vows openness", *Wall Street Journal*, 27 April 2006 (Accessed on the 26th November 2012, from ProQuest, Complutense Libraries).

⁹⁴ Mostovaia, "Gazovaia Firtaskha", *op. cit.*

⁹⁵ *Ibid.*

⁹⁶ Stepanenko and Grivach, "Kto igraet", *op. cit.*

⁹⁷ White, Crawford and Simpson, "At Gazprom partner", *op. cit.*

governments' intelligence services. It is quite unlikely that at least Gazprom, as an indirect member of RosUkrEnergo's owners, did not know it before. The same can possibly be said of the Ukrainian government. Probably neither Gazprom nor Naftohaz were interested in diffusing information about a deal that involved such obscure individuals and which would have discredited them.

7. 3. Yanukovich Government and Gas Relations with Russia

In an ironic twist of destiny, the March 2006 elections led to Viktor Yanukovich's nomination five months later in August as Prime Minister. This was the outcome of disagreements among the Orange leadership, which could not form a coalition together. Instead, the Socialist Party "betrayed" its former partners and joined the Communist Party and The Party of Regions. This had a clear consequence for energy relations with Russia, as the "old guard" under Kuchma made its comeback, mostly exemplified by Iurii' Boi'ko's nomination to the post of Minister of Energy (He headed Naftohaz until his substitution by Alexei' Ivchenko in 2005). As for policy, the most immediate consequence was the resurgence of the concept of a transport consortium to manage the Ukrainian gas infrastructure, with the inclusion of Gazprom, as had been planned under Kuchma's last years.

Ambiguous relations regarding the January agreement and RosUkrEnergo

The new government inherited a difficult legacy indeed. In early August RosUkrEnergo was threatening to sue Naftohaz at the Stockholm's Arbitrage Tribunal if a remaining debt believed to amount to US\$371,789mill was not paid by 15th August 2007.⁹⁸ RosUkrEnergo had already accumulated US\$390mill in losses and had a great need to recover badly needed money. The explanation for this new episode was quite complex and added a new factor: RosUkrEnergo was supposed to have sold some of the Russian gas (more expensive, US\$230tcm), which was destined for Europe to Ukraine instead. This happened because a cold spell in the early weeks of the year had required additional consumption.⁹⁹ According to sources reached by *Vremia Novostei'*, Naftohaz was responsible for having left around 3.9bcm of Russian gas unpaid.¹⁰⁰ RosUkrEnergo's threat paid, as Naftohaz sent a first batch of debt,

⁹⁸ "Vchera (Вчера)" *Kommersant*, 2 August 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

⁹⁹ Derbilova, Ekaterina: "Sebe v ubyток (Себе в убыток)", *Vedomosti*, 4 August 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁰⁰ Grivach, Alexei': "'Naftogaz" nachal platit' ("Нафтогаз" начал платить)", *Vremia Novostei'*, 21 August 2006 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

US\$46.9mill, in the third week of August.¹⁰¹ Boi'ko later mentioned mid-October as the most likely deadline for completing the payment of all debts.¹⁰²

However, in a first sign of reversal of the previously tense relations, the new Minister of Finances and Deputy-Prime Minister, Mykola Azarov, welcomed RosUkrEnergo for the role it was playing, also declaring that cooperation would be sought with Russia.¹⁰³ After having derided the January agreements some months ago, the new Prime Minister, Viktor Yanukovich, stood now in favor of them in appreciation of the significant discount Ukraine was granted.¹⁰⁴ Still, Azarov himself had to acknowledge that Naftohaz was de facto bankrupt,¹⁰⁵ talked of reforming the credit and gas policies,¹⁰⁶ while in the meantime, companies indebted to Naftohaz started being shut out of supplies.¹⁰⁷ Boi'ko's new declarations, criticizing the former government for leaving Naftohaz deprived of any rights to re-export gas to Europe,¹⁰⁸ were also an implicit criticism of the agreements in force since January. Many indeed, saw in Naftohaz's current predicaments the door for RosUkrEnergo's penetration as Gazprom's Trojan horse.¹⁰⁹ It was feared that RosUkrEnergo would demand compensation for debts in the form of shares in the company. As for example reported by *Vedomosti*, while Ukrainian legislation precluded any privatizing of Naftohaz, there existed the possibility of privatizing the shares of Naftohaz in subsidiary companies such as "Ukrnafty", "Ukrghazdobychi" and "Ukratnafty".¹¹⁰

Price negotiations and debt issues

Prime Minister Yanukovich's trip to Sochi, Russia to confer with his Russian counterpart, Mikhail Fradkov did not bring any breakthrough neither regarding debt nor regarding the issue of gas prices. An agreement was reached in relation with gas storage, as Ukraine committed to increase stored volumes to

¹⁰¹ *Ibid.*

¹⁰² Sergeev, Mikhail: "Ukraina predpalagaet Rossii gazovyi' barter (УКРАИНА ПРЕДЛАГАЕТ РОССИИ ГАЗОВЫЙ БАРТЕР)", *Gazeta*, 23 August 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁰³ "Ukraine govt not to revise gas supply plans with RosUkrEnergo", *Itar-Tass*, 7 August 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

¹⁰⁴ Grivach, Alexei': "'Preemstvennost'" i "nasledstvennost'" ("Преемственность" и "наследственность"), *Vremia Novostei'*, 8 August 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹⁰⁵ Reznik, Irina; Bekker, Alexandr and Kashin, Vasilii': "Ukraina proverit "Naftogaz" (Украина проверит "Нафтогаз")", *Vedomosti*, 8 August 2006 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

¹⁰⁶ *Ibid.*

¹⁰⁷ "Ukraina otkliuchaet gaz promyshlennym predpriyatiyam-dolshnikam (Украина отключает газпромышленным предприятиям-должникам)", *Vremia Novostei'*, 11 August 2006 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

¹⁰⁸ "Moody's peresmotrit rei'ting "Naftogaza" (Moody's пересмотрит рейтинг "Нафтогаза")", *Delovye Novosti*, 11 August 2006 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

¹⁰⁹ See for example: Sergeev, Mikhail: "Viktor Ianukovich otpravilsia v Sochi s podarkami (Виктор янукович отправился в сочи с подарками)", *Gazeta*, 15 August 2006 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

¹¹⁰ Reznik, Bekker and Kashin, "Ukraina proverit", *op. cit.*

24.5bcm by year end,¹¹¹ but President Yanukovich's confidence of keeping gas prices at US\$95bcm into 2007 did not seem very realistic.¹¹² Rumours about what Ukraine might offer to Russia in the energy sector in exchange for price reductions prompted the Minister of Energy to publicly reject the option of privatizing the GTS.¹¹³ However, Boi'ko's proposal, on the eve of a trip to Moscow,¹¹⁴ to allow UkrGazEnergo to penetrate into the market of OblHazy in exchange for the company's right to enter production projects in Russia,¹¹⁵ arguably justified such rumours. The Prime Minister stepped in (either warning their Russian partners before negotiations or reassuring internal opinion) when he announced that everything would be undertaken in order to keep current prices, even if that meant reviewing RosUkrEnergo's actual role, catering thus to the anti-RosUkrEnergo narrative.¹¹⁶ Boi'ko himself after his trip to Moscow had to support RosUkrEnergo to defend the status quo.¹¹⁷ It seemed that regarding this controversial option, there were contending points of view within the majority.¹¹⁸

Regarding Ukraine's margin of maneuver for gas prices, it was necessarily determined by what happened in Central Asia. And news from there was not particularly good. Gazprom had signed a contract to buy each year up to 50bcm of Turkmen gas until 2009. The price contracted was a clear cession to Turkmenistan: US\$100bcm as initially wanted by Turkmenistan. Worse, the new price would apply from

¹¹¹ Sergeev, Mikhail: "Gazu nashli zimnie kvartiry (газу нашли зимние квартиры)", *Gazeta*, 17 August 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹¹² Grivach, "Odnogo zhelaniia", *op. cit.*

¹¹³ Rebrov, Denis and Gavrish, Oleg: "'Gazpromu' predlozhili spustit'sia na oblastnoi' uroven' v ukrainskikh gazoprovodakh" ("Газпрому" предложили спуститься на областной уровень в украинских газопроводах)", *Kommersant*, 22 August 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹¹⁴ Grivach, Alexei': "Nikto ne khochet v Ashkhabad (Никто не хочет в Ашхабад)", *Vremia Novostei'*, 23 August 2006 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

¹¹⁵ Rebrov and Gavrish, "'Gazpromu' predlozhili", *op. cit.*. In late August there was still no confirmed news about Gazprom having made any request.

¹¹⁶ Reznik, Irina; Ivzhenko, Tat'iana and Kashin, Vasilii': "Ianukovich predupredil Rosukrenergo (Янукович предупредил Росукрэнерго)", *Vedomosti*, 24 August 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹¹⁷ Stepanenko, Svetlana: "Ukraina ne mozhет otkazat'sia ot uslug "Rosukrenergo" ("Украина не может отказаться от услуг "Росукрэнерго")", *Vremia Novostei'*, 4 September 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹¹⁸ As it would be revealed in early 2007 through disagreements within the ruling majority regarding changes in the GTS legal status, there was a division between supporters of RosUkrEnergo and opponents. This in fact led to the sacking of Vladimir Sheludchenko and his substitution by Evgenii' Bakulin as Head of Naftohaz, with the former being the protégé of Vice-Prime Minister Andrii' Kliuev and the latter an ally of Iurii' Boi'ko (see: Kozhukhar', Irina: "V "Naftogaze" sminilos' rukovodstvo (В "НАФТОГАЗЕ" СМЕНИЛОСЬ РУКОВОДСТВО)", *Nezavisimaia Gazeta*, 6 March 2007 (Accessed on 18th August 2011, from East View, Harvard Libraries); both groups not only had opposite views on the GTS (see section below, in p. 210), but obviously also harbored different intentions regarding RosUkrEnergo, with Kliuev having considered direct supplies (see: Grivach, Aleksei': "Rokovaia rokirovka (Роковая рокировка)", *Vremia Novostei'*, 2 March 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries); "Kambin otkazhetsia ot posrednika v otnosheniakh s "Gazpromom"? (Кабмин откажется от посредника в отношениях с "Газпромом"?", *Ukrainskaia Pravda*, 5 February 2007, at <http://www.pravda.com.ua/rus/articles/2007/02/5/4412620/> (Accessed on the 10th January 2013) and even threatened to substitute RosUkrEnergo by Itera (see: "Kliuev ne iskluchaet, chto "Itera" zamenit "RosUkrEnergo" (Клюев не исключает, что "Итера" заменит "РосУкрЭнерго")", *Ukrainskaia Pravda*, 14 February 2007, at <http://www.pravda.com.ua/rus/articles/2007/02/14/4413296/> (Accessed on the 10th January 2013).

October 2006. Final prices at the border with Ukraine were to reach US\$130tcm. Naftohaz could only determine in triangular conversations with Gazprom and RosUkrEnergo minor details, but had necessarily to accept such prices.¹¹⁹ When news of this came, Ukraine looked for ways to avert either a dramatic increase of prices for Ukrainian end consumers or bankruptcy of Naftohaz (in a dire situation already since it paid US\$95tcm), if it kept subsidizing internal prices.

The government had been toying already with the idea of reinforcing the presence of RosUkrEnergo at the expense of UkrGazEnergo, as the former was credited for being a guarantor of low prices.¹²⁰ As RosUkrEnergo's margin of action was equally determined by Central Asian gas prices, it is difficult to know what the government really intended. Another tactic was to impose on the trader all costs derived from price increases, under the vague promise of being eventually compensated by Naftohaz later.¹²¹ As RosUkrEnergo made substantial profits out of gas exported to Europe, there was a margin for this, indeed, but it was not realistic to force a private actor to give up profits. Whatever the eventual consequences, the only realistic option for Ukraine was acknowledged by the Ukrainian Prime Minister in a visit to Moscow: to accept higher prices. The government did however try to postpone the price increase to 2007.¹²²

Apart from this limited revisionism, other long-term mechanisms were tried out: Iurii' Boi'ko proposed a progressive calendar for the next three years, with the transit tariff increasing whenever prices were raised. Gazprom did not find this option attractive and preferred to maintain the transit tariff fixed at 1.6tcm/100km for the whole period covered (five years, from 2006 to 2011) by the January agreements.¹²³ If revising contracts was not crowned with success, Naftohaz nevertheless agreed with RosUkrEnergo and Gazprom in late September to keep prices unchanged for the fourth quarter of 2006.¹²⁴ Whether resulting losses would be absorbed by either Gazprom or RosUkrEnergo was not revealed. *Izvestiia* speculated that RosUkrEnergo would charge with the costs and would be later compensated with

¹¹⁹ Grivach, "Gazovyi' siurpriz", *op. cit.*

¹²⁰ "Naftogaz Ukrainy" khochet pokupat' gaz u RosUkrEnergo ("Нафтогаз Украины" хочет покупать газ у RosUkrEnergo)", *Vedomosti*, 5 September 2006 (Accessed on the 17th August 2011, from East View, Harvard Libraries); although no details were developed in this scheme, it might be suspected that the issue consisted of saving from the profits that UkrGazEnergo made at the expense of consumers.

¹²¹ Grib, Natal'ia and Gavrish, Oleg: "Rosukrenergo zaplatit za gaz dlia Ukrainy (Rosukrenergo заплатит за газ для Украины)", *Kommersant*, 12 September 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹²² Sergeeva, Iana: "Ianukovich ne budet togovat'sia po gazu (ЯНУКОВИЧ НЕ БУДЕТ ТОРГОВАТЬСЯ ПО ГАЗУ)", *Novye Izvestiia*, 22 September 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹²³ Grivach, Alexei': "Trekhletnii' put' (Трехлетний путь)", *Vremia Novostei'*, 12 October 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹²⁴ "Tseny na gaz dlia Ukrainy v IV kvartale ostanutsia prezhnimi (Цены на газ для Украины в IV квартале останутся прежними)", *Izvestiia*, 28 September 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

increased export licenses¹²⁵ (that would inevitably come at the expense of gas sold directly to Europe by Gazprom).

Once Naftohaz achieved this small victory, next rounds were devoted to determining final conditions for 2007. The formula that Ukraine had accepted allowed prices to be retained at a more favorable rate than would have been the case if only Russian gas was consumed instead.¹²⁶ Thus, it was confirmed that for 2007 only a portion of Russian gas would be consumed in Ukraine: if as planned, RosUkrEnergo sold 14bcm of Russian gas to Europe,¹²⁷ that left only 3bcm for Ukraine.¹²⁸ There was still uncertainty regarding prices for the "third leg" of the January 2006 agreements, namely, for Uzbek and Kazakh gas. Boi'ko seemed to be counting on prices of US\$106tcm.¹²⁹ In any case a final agreement was reached in mid-October that secured for Ukraine 55bcm of gas for 2007 (and offered the possibility of as much as 60bcm for 2008-09)¹³⁰ at the expected price of US\$130tcm.¹³¹ A parallel agreement was at the same time reached between RosUkrEnergo and UkrGazEnergo,¹³² valid for the three next years and planning that annual revisions of both prices and volumes would be determined by an additional protocol.¹³³ Some criticism was raised in Russia against the concessions made to the Ukrainian side, which obtained "favorable" prices.¹³⁴ Vorob'ev and Grivach in *Vremia Novosti*, negatively compared the 35% increase to 100-150% which it "might be otherwise" (emphasis mine).¹³⁵ The authors considered what prices would be if Ukraine were to buy all of its gas from Russia at market prices and were thus indirectly criticizing the agreement of January 2006.

Some questions were left unanswered concerning the final "cocktail" of Central Asian gas and regarding whether RosUkrEnergo or Ukrainian end-consumers would assume the new prices. According

¹²⁵ *Ibid.*

¹²⁶ Gavrish, Oleg: "Ukraina otdyshalas' ot rossiiskogo gaza (Украина отдышалась от российского газа)", *Kommersant*, 9 October 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹²⁷ Grivach, "Trekhnii put", *op. cit.*

¹²⁸ In fact, as would be eventually known, no Russian gas at all would be imported in 2007 (see: Reznik, Irina: "Analitika: Iamlorossii'skaia trgovlia (Аналитика: Ямалороссийская торговля)", *Vedomosti*, 1 April 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹²⁹ Gavrish, "Ukraina otdyshalas'", *op. cit.*

¹³⁰ Ivanova, Svetlana; Ivzhenko, Tat'iana; Reznik, Irina and Bekker, Aleksandr: "Torg prodolzhaetsia (Торг продолжается)", *Vedomosti*, 25 October 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

¹³¹ "RosUkrEnergo, UkrGazEnergo agree on Central Asian gas supplies", *Itar-Tass*, 24 October 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹³² Lavrov, Andrei': "Kievskii' blitskrig (КИЕВСКИЙ БЛИЦКРИГ)", *Gazeta*, 24 October 2006 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

¹³³ Lavrov, Andrei': "Zagazovannaia reputatsiia (ЗАГАЗОВАННАЯ РЕПУТАЦИЯ)", *Gazeta*, 25 October 2006 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

¹³⁴ Sergeeva, Iana: "E'nergeticheskii' kokteil' Ianukovicha (ЭНЕРГЕТИЧЕСКИЙ КОКТЕЙЛЬ ЯНУКОВИЧА)", *Novye Izvestiia*, 25 October 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

¹³⁵ Vorob'ev, Mikhail and Grivach, Alexei': "Ne zamerznut (Не замерзнут)", *Vremia Novosti*, 25 October 2006 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

to latest reports, as much as 10bcm of gas would be purchased from Uzbekistan and 8bcm from Kazakhstan.¹³⁶ This meant in fact that RosUkrEnergo would not sell Russian gas to UkrGazEnergo. As for the profit margin of RosUkrEnergo, the company itself confirmed that it would not sell at a loss,¹³⁷ as the new price represented roughly the costs the company had to assume after purchasing gas from Turkmenistan and transporting it to the Ukrainian border.¹³⁸ RosUkrEnergo secured a situation similar to 2006, when prices at US\$95tcm covered costs related to Central Asian gas, while it could make sizeable profits from Russian gas sold to Europe. *Vremia Novostei* supported what was reported earlier by *Izvestiia*, namely, that costs of preserving US\$95tcm for the last quarter of 2006 would be assumed by RosUkrEnergo.¹³⁹ Whether RosUkrEnergo could sell more Russian gas in 2007 as suspected by *Izvestiia* as a compensation,¹⁴⁰ was not confirmed.

Concerning Naftohaz and UkrGazEnergo's remaining debt, the Ukrainian Minister of Energy blamed the former management for having sold imported gas to households instead of cheaper domestic gas.¹⁴¹ By mid-November half of the total debt seemed to have been repaid, while Boi'ko promised to pay the remaining half before year's end.¹⁴² *Itar-Tass* reported that US\$14mill had been handed over in November and US\$306mill on December 1st.¹⁴³ Considering previous payments in June of US\$200mill and US\$111mill in November, the whole debt seemed indeed to have been covered.¹⁴⁴ Regarding the

¹³⁶ *Ibid.*

¹³⁷ Ivanova, Ivzhenko, Reznik and Bekker, "Torg prodolzhaetsia", *op. cit.*

¹³⁸ See: *Ibid.*

¹³⁹ See: Grivach, Alexei': "Tsena gazovogo mira (Цена газового мира)", *Vremia Novostei*, 12 December 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries). Konstantin Chui'chenko acknowledged this fact in an interview to *Kommersant* in January 2007 (around US\$300mill of losses for RosUkrEnergo). As for the credibility we can attribute to his assertion that part of all the losses by RosUkrEnergo in 2006 came from Russian gas priced at US\$230tcm having been sold at US\$95tcm (see: Grib, "Struktura benefitsiarov", *op. cit.*), this may concern at least some 1.4bcm of Russian gas, which according to *Vremia Novostei*, were sold in the first half of 2006 at the price of US\$95tcm, the loss of around US\$190mill being written down to RosUkrEnergo (see: Grivach, "Tsena gazovogo", *op. cit.*). This matches closely with Chui'chenko's calculations, from where a loss of around US\$150mill can be deduced (see: Grib, "Struktura benefitsiarov", *op. cit.*).

¹⁴⁰ "Tseny na gaz dlia Ukrainy", *op. cit.*

¹⁴¹ Stetsiura, Raisa: "Naftogaz Ukrainy to pay off debt to RosUkrEnergo by yearend", *Itar-Tass*, 10 November 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries); credit for this latest payment came from "Credit Suisse", who had lent US\$350mill to Naftogaz ("Naftogaz Ukrainy" poluchil kredit na pogasheniia zadolzhennosti ("Нафтогаз Украины" получил кредит на погашение задолженности)", *Vremia Novostei*, 8 December 2006 (Accessed on the 23rd August 2011, from East View, Harvard Libraries). The minister accused the former leadership of having sold imported gas from RosUkrEnergo to the Ukrainian local population instead of much cheaper Ukrainian gas, which ended up in the hands of the group "Privat" (oligarch Igor Kolomoï'skii'), owner of 40% of the subsidiary of Naftogaz, "UkrNafta" (see: Ivzhenko, Tat'iana: "Deshevyi' gaz ne dlia ukraintsev (Дешевый газ не для украинцев)", *Vedomosti*, 24 November 2006 (Accessed on the 17th August 2011, from East View, Harvard Libraries); apparently the US\$600mill that Naftohaz owed RUE seemed to have its origin in a practice starting from 2004 (see: *Ibid.*).

¹⁴² Stetsiura, "Naftogaz Ukrainy", *op. cit.*

¹⁴³ Matarykin, Vitaly: "Neftegaz Ukrainy pays main debt to RosUkrEnergo", *Itar-Tass*, 05 December 2006 (Accessed on 31st August 2011, from East View, Harvard Libraries).

¹⁴⁴ Trempel' Aleksandr: "Naftogaz" rasschitalsia s dolgami pered Rosukrenergo ("НАФТОГАЗ" РАССЧИТАЛСЯ С ДОЛГАМИ ПЕРЕД ROSUKRENERGO)", *Gazeta*, 6 December 2006 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

financial situation of RosUkrEnergo, the company reported ending the year with profits of US\$780mill derived from 7.8bcm of gas sold to RosUkrEnergo by Gazprom¹⁴⁵ and from a slight profit margin from transporting Central Asian gas, explained by transportation costs representing US\$25tcm instead of US\$30tcm, as usually reported by the press.¹⁴⁶ RosUkrEnergo's situation thus seemed to be somewhat better than reported, even if that probably was due to huge profits from 2005.

Projects for an international natural gas consortium

Once price and debt issues had been solved, 2006 ended with renewed expectations that the new government would introduce changes in the energy sector of Ukraine. There was talk again of privatization of energy networks and penetration into the internal energy market of Ukraine by RosUkrEnergo and Gazprom. According to *Vedomosti*, Ukrainian officials had offered Russia participation in the privatization of the sector of electricity in exchange for reduced prices; this opinion was subscribed to by Vladimir Saprykin from the Ukrainian "*Center Razumkov*".¹⁴⁷ Saprykin said that Gazprom might purchase regional gas networks, known as Oblhazy for the global amount of US\$500mill.¹⁴⁸

In a similar direction, a document prepared for the convening of the first (Russia-Ukraine) bilateral economic committee since 2004, agreed to review and analyze previous intergovernmental agreements in order to submit proposals for changes by the 1st of June 2007.¹⁴⁹ This could open the door to the signature of an intergovernmental agreement to create an international gas consortium. Boi'ko himself declared not to fear a monopoly by UkrGazEnergo and did not oppose RosUkrEnergo's purchase of assets in the secondary market of OblHazy either.¹⁵⁰ In an interview for the Ukrainian weekly *2000* (as relayed by *Vedomosti*), he reiterated his conformity with RosUkrEnergo's plans to obtain shares in the

¹⁴⁵ Gavrish, Oleg and Natal'ia Grib: "RosUkrEnergo obnaruzhila u sebia pribyl' (RosUkrEnergo обнаружила у себя прибыль)", *Kommersant*, 13 November 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries). This figure refers to the 7.8bcm of gas in controversy last year (see former chapter, pp. 134-136); however, the deal reached secured for RosUkrEnergo only 5.25bcm of gas instead (see former chapter, pp. 141-2), so either it must be supposed the deal was changed thereafter or the calculation from the article is wrong, as Konstantin Chui'chenko was still naming in January 2007 the same figures as in the original deal (see: Grib, ""Struktura benefitsiarov", *op. cit.*). Gas which was sold to RosUkrEnergo at US\$150tcm (see former chapter, p. 141 and Gavrish and Grib, "RosUkrEnergo obnaruzhila", *op. cit.*) was exported to Europe by US\$250tcm (see: *Ibid.*), that difference being the source of the profit.

¹⁴⁶ *Ibid.*; Korchemkin, Mikhail: "RosUkrEnergo Wins, Gazprom and NAK Lose", *East European Gas Analysis*, 6 March 2006, at <http://www.eegas.com/ukrtran6.htm> (Accessed on the 6th November 2012). This was mentioned already in ft. 257, p. 169 of previous chapter.

¹⁴⁷ Ivanova, Ivzhenko, Reznik and Bekker, "Torg prodolzhaetsia", *op. cit.*

¹⁴⁸ *Ibid.*

¹⁴⁹ Lavrov, "Zagazovannaia reputatsiia", *op. cit.*

¹⁵⁰ Stetsiura, "Naftogaz Ukrainy", *op. cit.*

regional electrical market of Ukraine.¹⁵¹ *Kommersant* in fact, following what the same daily had suspected back on 11th September,¹⁵² reported that RosUkrEnergo's profits would go to the acquisition of shares in the market of OblHazy.¹⁵³ Some days later, Chui'chenko, representative of Gazprom in RosUkrEnergo, cryptically hinted that both Russo-Ukrainian relations and internal Ukrainian factors *were very important* (emphasis mine). In fact, on December, 6 OblHazy publicly accused the ruling government of pressuring them through investigations by security services at the behest of RosUkrEnergo, in retaliation for rejecting to sell their shares.¹⁵⁴

2007 started the same way as 2006 had ended, namely, with movements by RosUkrEnergo to penetrate the Ukrainian energy market. There were news that Naftohaz was to rid itself of some of its non-core investments.¹⁵⁵ This could improve its delicate economic situation but also played into RosUkrEnergo's hands. It was soon reported that Naftohaz would sell its shares in several OblHazy.¹⁵⁶ In addition to that, Russian President Vladimir Putin himself referred in February to a scheme where Naftohaz would receive the right to enter the Russian upstream market as a compensation for opening Ukraine's GTS.¹⁵⁷ The Russian President was explicit in his mention of the project of an International Consortium.¹⁵⁸ There seemed to be a clear convergence of purposes: the Ukrainian Prime Minister had already stated in early December 2006: "*the \$230 price is but a respite*" (emphasis mine).¹⁵⁹ Following up on his previous declarations, he now said: "Our goal is to receive cheaper gas. *The market price of gas is impossible for Ukraine at present* (emphasis mine). We still cannot come around after the twofold price increase. The participation in the development of deposits will make gas cheaper".¹⁶⁰ Whether that would really guarantee lower prices is debatable. However, he was echoing Putin's scheme. The daily

¹⁵¹ "Boi'ko gotovit pochvu (Бойко готовит почву)", *Vedomosti*, 14 November 2006 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹⁵² See: Gavrish, Oleg and Natal'ia Grib: "Rosukrenergo otsenilo ukrainskie oblgazy dlia sozdaniia distributorskoi' seti na Ukraine (Rosukrenergo оценило украинские облигации для создания дистрибуторской сети на Украине)", *Kommersant*, 11 September 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁵³ Gavrish and Grib, "RosUkrEnergo obnaruzhila", *op. cit.*

¹⁵⁴ Drabchuk Vladimir and Gavrish, Oleg: "Siloviki produvaiut gazovye truby (Силовики продувают газовые трубы)", *Kommersant*, 11 December 2006 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁵⁵ "Naftogaz Ukrainy" izbavitsia ot neprofil'nykh aktivov ("Нафтогаз Украины" избавится от непрофильных активов)", *Vremia Novostei'*, 26 January 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁵⁶ Grib, Natal'ia: "Ukrainskie oblgazy prodaiutsia (Украинские облигации продаются)", *Kommersant*, 31 January 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁵⁷ Grivach, Alexei': "Intriguiushchii' signal (Интригующий сигнал)", *Vremia Novostei'*, 2 February 2007 (Accessed on the 24th August 2011, from East View, Harvard Libraries); Reznik, Irina; Ivanitskaia, Nadezhda and Ivzhenko Tat'iana: "Ukraina prositsia v Rossiiu (Украина просится в Россию)", *Vedomosti*, 2 February 2007 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

¹⁵⁸ Grivach, "Intriguiushchii' signal", *op. cit.*

¹⁵⁹ Kozhukhar', Irina: "peredyska dlia Ianukovicha (передышка для януковича)", *Nezavisimaia Gazeta*, 5 December 2006 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁶⁰ "Ukraine law protects gas transportation system", *Itar-Tass*, 6 February 2007 (Accessed on the 31th August 2011, from East View, Harvard Libraries).

Kommersant identified the Ukrainian Ministry of Energy under Iurii' Boi'ko as the origin of the proposal.¹⁶¹ The proposal in question contained three variants, one of which represented a strong version of integration: an International Consortium to manage the Ukrainian network, with the participation of Gazprom and in exchange for access to the Russian downstream sector.¹⁶² This is precisely what Putin had already mentioned and his preferred option¹⁶³ was clearly what the government was ready to promote too. However, there were many difficulties ahead.

In fact, the whole project would end up in fiasco. The strong divergences within the ruling Party of Regions and the belligerence of the opposition played in favor of this outcome.¹⁶⁴ Vice-Prime Minister Andrii' Kliuiev was quick to remind all that changes in the ownership of energy infrastructures required a constitutional amendment (337 out of a total of 450 seats). That clearly overcame the 246 representatives the Party of Regions could count on.¹⁶⁵ It may also explain Putin's readiness to meet with President Yushchenko, it being much easier to deal with his party "Nasha Ukraina" than with the more radical "Iulia Timoshenko's Bloc".¹⁶⁶ Timoshenko was adamant in her opposition, indeed, declaring that she would: "*not allow the parliament to work until a bill is adopted that will ban any manipulations with the Naftohaz of Ukraine company*".¹⁶⁷

In consequence, she submitted a bill in support of the current status of Naftohaz, which was voted on 6th February 2007 and which gathered an almost unanimous approval (430 out of 450 representatives).¹⁶⁸ The bill banned any transfer of Ukraine's GTS to foreign countries.¹⁶⁹ Subsequent declarations from government officials rejecting any kind of participation by third parties,¹⁷⁰ were either a face-saving device or an acknowledgement that themselves were from the very beginning opposed.¹⁷¹ In

¹⁶¹ Grib, Natal'ia and Gavrish, Oleg: "Ukrainskie truby podtjanut k rossii'skim nedram (Украинские трубы подтянут к российским недрам)", *Kommersant*, 2 February 2007 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

¹⁶² *Ibid.*

¹⁶³ *Ibid.*

¹⁶⁴ "Opposition readying to block Ukraine parliament building", *Itar-Tass*, 6 February 2007 (Accessed on the 31th August 2011, from East View, Harvard Libraries).

¹⁶⁵ Grib and Gavrish, "Ukrainskie truby", *op. cit.*

¹⁶⁶ *Ibid.*

¹⁶⁷ "Opposition readying to block Ukraine", *op. cit.*

¹⁶⁸ "Ukraine parliament anxious over gas consortium with Russia", *Itar-Tass*, 6 February 2007 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

¹⁶⁹ "Ukraine law protects", *op. cit.* See a further analysis in: Ivzhenko, Tat'iana and Kashin, Vasili': "SP s "Gazpromom" pod zapretom (СП с "Газпромом" под запретом)", *Vedomosti*, 7 February 2007 (Accessed on the 18th August 2011, from East View, Harvard Libraries); Zygari', Mikhail: "Rossii dali gazootvod (России дали газоотвод)", *Kommersant*, 7 February 2007 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

¹⁷⁰ *Ibid.*; Grivach, Alexei': "Nikomu nichego (Никому ничего)", *Vremia Novostei*, 7 February 2007 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

¹⁷¹ The Cabinet of Ministers had actually issued a statement refusing any responsibility in the proposal altogether (see:

"Kambin otkreshchivaetsia ot initsiativ Putina po povodu ukrai'nskoï' GTS (Кабмин отрешивается от инициатив Путина

the next days after this defeat, there was talk about a downsized alternative: to swap UkrGazEnergo's shares in exchange for investments in Russian downstream sector.¹⁷² This was never given any continuity.

Interlude: reduced tensions and increased harmony for most of 2007

After this convulsed beginning, the next months were surprisingly uneventful: Gazprom, after making clear that non-subsidized gas would be provided after 2011,¹⁷³ unsuccessfully tried to resurrect projects similar to that recently defeated in the Rada.¹⁷⁴ Boi'ko preemptively reassured the public that Ukraine would only see prices grow within an acceptable range of 7-10 % the next year.¹⁷⁵ Mr. Robert Shettler-Jones, share-owner in the chemical sector within the Group DF (headed by Dmitro Firtash), went in a similar direction and also forecast only slightly higher prices for 2008.¹⁷⁶ An article by *Ukrainska Pravda* in August 2007 gathered the assessment by several specialists, who stated that in the context of increasing world energy prices, a 10% percent hike would be the minimum to assume.¹⁷⁷ Therefore, prices of US\$143tcm for 2008 could be considered a success.¹⁷⁸ If Ukraine still believed in bypassing Russia, as actively sought under Timoshenko's government (see chapter 6) Russia's recent agreement with Kazakhstan and Turkmenistan in the summit of May 2007 cast even more shadow on an already unrealistic project: that agreement foresaw building the Caspian Pipeline (this project competed with the European and US-supported project Nabucco, which other countries from the FSU, such as Azerbaijan, Georgia, Lithuania and Ukraine supported).¹⁷⁹

по поводу украинской ГТС), *Ukrainskaia Pravda*, 5 February 2007, at <http://www.pravda.com.ua/rus/articles/2007/02/5/4412696/> (Accessed on the 10th January 2013). It is fair to assume that proposals from the Ministry of Energy were at odds with the government's policy (see page below).

¹⁷² Grib, Natal'ia and Gavrish, Oleg: "Ukraina vlozhtsia v rossiiskie nedra (Украина вложится в российские недра)", *Kommersant*, 19 February 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁷³ In this context, non-subsidized gas meant Russian gas and not cheap Central Asian gas, which Gazprom would have preferred to have free access to.

¹⁷⁴ "Gazprom" sobiraetsia obdirat' Ukrainu po-evropei'ski ("Газпром" собирается обдирать Украину по-европейски)", *Ukrainskaia Pravda*, 1 March 2007, at <http://www.pravda.com.ua/rus/news/2007/03/1/4414138/> (Accessed on the 11th January 2013); "Gazprom" khochet rabotat' s Ukrainoi' v obkhod RosUkrEnergo ("Газпром" хочет работать с Украиной в обход РосУкрЭнерго)", *Ukrainskaia Pravda*, 1 March 2007, at <http://www.pravda.com.ua/rus/news/2007/03/1/4414094/> (Accessed on the 11th January 2013).

¹⁷⁵ "Boi'ko podverdil budushchee povyshenie tsen na gas (Бойко подтвердил будущее повышение цен на газ)", *Ukrainska Pravda*, 21 May 2007, at <http://www.pravda.com.ua/rus/news/2007/05/21/4418459/> (Accessed on the 13th January 2013).

¹⁷⁶ Gavrish, Oleg: "Robert Shetler-Jones: za pravo tranzita predlagaem Ukraine gaz po niskoi' tsene (Роберт Шетлер-Джонс: за право транзита мы предлагаем Украине газ по низкой цене)", *Kommersant*, 25 June 2007, at <http://www.kommersant.ua/doc/777678> (Accessed on the 14th January 2013).

¹⁷⁷ "Eksperty reshili, chto gaz na 10% dorozhe – eto eshche khorosho (Эксперты решили, что газ на 10% дороже – это еще хорошо)", *Ukrainska Pravda*, 23 August 2007, at <http://www.pravda.com.ua/rus/news/2007/08/23/4423030/> (Accessed on the 15th January 2013).

¹⁷⁸ *Ibid.*

¹⁷⁹ Martynov, Kirill: "Tsena pobedy (Цена победы)", *Kommersant*, 26 June 2007, at <http://www.kommersant.ru/doc/776134?isSearch=True> (Accessed on the 14th January 2013).

As for the "internal front", UkrGazEnergo unsuccessfully attempted in May 2007 to charge higher prices to the metallurgical industry. UkrGazEnergo was thus trying to pass on to the consumers the costs of gas that was being stored in underground facilities since June 2006.¹⁸⁰ Meanwhile, RosUkrEnergo and Gazprom reached a new agreement on cooperation for sales in Europe: RosUkrEnergo would be selling up to 4bcm every year of gas to Gazprom at US\$250tcm (or as some experts expected for the end of the year, at US\$270-90tcm), which the latter would then resell in Europe at market prices. From these volumes, one third would come from Central Asia (Kazakhstan and/or Uzbekistan) at US\$95tcm, another third from Turkmenistan at US\$130tcm and the rest from Gazprom at US\$160tcm. In exchange, Gazprom could have access to_ (RosUkrEnergo's) gas stored in Ukrainian storage facilities, which enabled the Russian company to respond more quickly to changes in demand.¹⁸¹

New debt dispute sets the scene for next dispute

This situation of relative impasse that had prevailed during most of the year changed abruptly in October: a new debt issue exploded between Russia and Ukraine. On 3rd October Gazprom's press service laconically stated that in a meeting with their Ukrainian counterpart, it was agreed to pay the debt for gas no later than by November 1st.¹⁸² An earlier statement and several press reports offered some more details: Gazprom referred to an accumulated debt of US\$1.3bill for natural gas consumed during the year and warned that failing to pay would result in reduced supplies.¹⁸³ It is worth remarking that Gazprom's response was particularly harsh, as the problem of debt was linked this time with a suspension of gas deliveries.

The first reactions from the Ukrainian side were contradictory. In fact, they came from RosUkrEnergo and Naftohaz: RosUkrEnergo acknowledged the debt and named the figure of more than US\$1bill.¹⁸⁴ Naftohaz on the contrary, questioned it and expressed its surprise regarding Gazprom's

¹⁸⁰ "Iushchenko naekhal na dochku "Rosukrenergo" (Ющенко наехал на дочку "Росукрэнерго"?), *Ukrainskaia Pravda*, 13 June 2007, at <http://www.pravda.com.ua/rus/news/2007/06/13/4419843/> (Accessed on the 14th January 2013).

¹⁸¹ Gavrish, Oleg and Grib, Natal'ia: "Gazprom" i RosUkrEnergo likvidiruiut konkurentsiiu ("Gazprom" I RosUkrEnergo likvidiruiut konkurentsiiu)", *Kommersant*, 27 June 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries). As we understand here, this probably meant that Gazprom could swap its gas as it usually did in winter with Naftohaz, in order to respond to peaks of demand in Europe. Whatever gas under Naftohaz and RosUkrEnergo's property used by Gazprom was compensated for thereafter by the latter, to cover their consumption or sale needs.

¹⁸² "On working meeting between Alexey Miller and Yury Boiko", *Gazprom News*, 3 October 2007, at <http://www.gazprom.com/press/news/2007/october/article63989/> (Accessed on the 15th January 2013).

¹⁸³ "Press statement", *Gazprom News*, 2 October 2007 at <http://www.gazprom.com/press/news/2007/october/article63991/> (Accessed on the 15th January 2013); Mordiusenko, Ol'ga and Gavrish, Oleg: "Dolg platezhom oranzhev (Долг платежом оранжев)", *Kommersant*, 3 October 2007 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

¹⁸⁴ Kashin, Vasilii: "'Gazprom' trebuat rasplaty («Газпром» требует расплаты)", *Vedomosti*, 03 October 2007 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

calculations.¹⁸⁵ Vice-Prime Minister Azarov chose a middle way, considering these figures to be inflated,¹⁸⁶ but nevertheless acknowledging the existence of the debt, blaming UkrGazEnergo and RosUkrEnergo.¹⁸⁷ A source from Naftohaz ended up acknowledging that around US\$500mill (which according to *Vremia Novosti* equaled 3.5bcm of gas) had accumulated from non-payments to UkrGazEnergo by private companies.¹⁸⁸ Sources from RosUkrEnergo seemed to point to UkrGazEnergo as the source of the whole volume of debt.¹⁸⁹

It seemed fairly clear at this stage that at least part of this debt came from consumers indebted to UkrGazEnergo. This debt had moved up the ladder and then affected RosUkrEnergo and Gazprom as a result. Some days later, sources from Gazprom clarified the breakdown of the whole debt, which proved more complex than initially assumed, as Naftohaz was involved too: according to Gazprom, US\$700mill were owed by Naftohaz to UkrGazEnergo, US\$300mill were owed by UkrGazEnergo to RosUkrEnergo and an additional sum of US\$300mill owed by RosUkrEnergo directly to Gazprom.¹⁹⁰ The first figure might have been related to the US\$500mill which were reported by the Ukrainian daily *Delo*.¹⁹¹ This was in any case the only debt Naftohaz acknowledged.¹⁹² In fact, the Secretary of the Ukrainian Presidency, Aleksandr Shlapak, did acknowledge a debt of US\$700mill.¹⁹³ This breakdown was confusing and would be later clarified with additional information.

Besides the objective economic reasons, this new row coincided with the results of anticipated parliamentary elections in September 2007. These elections happened to throw up an "orange" majority and thus announced a change of government. Therefore, speculations necessarily abounded over supposed political reasons that could account for the timing. Valerii Nesterov from "Troika Dialog" acknowledged this possibility, but still considered that given the (economic) substance of the problem, the

¹⁸⁵ *Ibid.*

¹⁸⁶ Veletmisnikii, Igor': "Den'gi ot del'no, vybory ot del'no (Деньги отдельно, выборы отдельно)", *Rossii'skaia Gazeta*, 4 October 2007 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

¹⁸⁷ Kapustin, Andrei': "Gazovoe poslevkusie (Газовое послевкусие)", *Novye Vremia*, 8 October 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁸⁸ Grivach, Alexei': "Oktiabr'skaia "kontrevoliutsiia" (Октябрьская "контрреволюция)", *Vremia Novosti*, 3 October 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁸⁹ Lavrov, Andrei' and Gavshina, Oksana: "Gaz ne stanet oranzhevym (газ не станет оранжевым)", *Gazeta*, 3 October 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁹⁰ "Naftogaz Ukrainy accounts for bulk of gas debt to Russia", *Itar-Tass*, 9 October 2007 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

¹⁹¹ "Dokhody "Naftogaza" upali v dva raza (Доходы «Нафтогаза» упали в два раза)", *Delo*, 7 October 2007, at <http://delo.ua/business/dohody-naftogaza-upali-v-dva-55553/> (Accessed on the 16th January 2013).

¹⁹² Beliaikov, Evgenii' and Tovkai'lo, Maksim: "skazka o poteriannom gaze (сказка о потерянном газе)", *Gazeta*, 9 October 2007 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

¹⁹³ Viktorov, Viktor: "Prem'ery pogasili fakel (премьеры погасили факел)", *Trud*, 10 October 2007 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

debt dispute would have nevertheless surfaced sooner or later.¹⁹⁴ However, it is true that some declarations by Gazprom before the elections were undisguised attempts at political manipulation. This clearly was the case when affordable prices (US\$145-175tcm) were offered, but only if the current leadership remained; otherwise, US\$230tcm were to be expected.¹⁹⁵ The Russian ambassador and former Prime Minister Viktor Chernomirdin expressed himself along similar lines before the elections.¹⁹⁶ An article by Andrew Neff from *Global Insight* theorized about the possible use by Russia of its position as a transit country for Central Asian gas to Ukraine to blackmail the prospective new government of Timoshenko with higher prices.¹⁹⁷ Such declarations were probably linked to the elections rather than representing a real negotiating position. Now that the elections were over and its political results could not be changed, the priority for Gazprom was to solve the debt issue.

Iurii' Boi'ko met with his Russian counterpart on 3rd October 2007 to settle the debt issue by November 1st. At a follow-up meeting on 8th October both parts discussed the scheme for paying back the debt and the next day, during a visit by Prime Minister Yanukovich to Russia, documents were signed between Naftohaz, Gazprom and UkrGazEnergo. Boi'ko anticipated that the scheme would involve both financial repayments and repayments in kind.¹⁹⁸ Thus, 4.5bcm of gas worth US\$600mill would be returned to Gazprom by UkrGazEnergo.¹⁹⁹ The rest would be repaid through financial transfers on the basis of Naftohaz and UkrGazEnergo capitals. According to RosUkrEnergo the agreements ensured that it could reduce supplies to Ukraine if payments were not made on time.²⁰⁰ Then, declarations by Russian Prime Minister Viktor Zubkov blurred the whole picture pointing to a (erroneously) higher debt of not US\$1.3bill as said earlier, but US\$2bill.²⁰¹ He further specified that most of the amount would be integrally repaid through gas transfers by RosUkrEnergo. A remaining volume of US\$929mill would be repaid financially through transfers between Naftohaz and UkrGazEnergo.²⁰²

¹⁹⁴ Mordiusenko and Gavrish, "Dolg platezhom", *op. cit.*

¹⁹⁵ Lavrov and Gavshina, "Gaz ne stanet", *op. cit.* Gazprom's justification, on the contrary, was that they did not raise the issue of debt before the elections so as not to exert pressure on the political process (see: Grivach, "Oktiabr'skaia "kontrevoliutsiia"", *op. cit.*), which makes any way perfect sense, as this probably would have backfired in favour of the orange block (see analysis: Kapustin, "Gazovoe poslevkusie", *op. cit.*

¹⁹⁶ Neff, Andrew: "Iuliia Timoshenko pered trudnym vyborom (Iulia timoshenko перед трудным выбором)", *Nezavisimaia Gazeta*, 3 October 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁹⁷ *Ibid.*

¹⁹⁸ Grivach, Alexei': "Poka prem'er ne pomenialsia (Пока премьер не поменялся)", *Vremia Novostei'*, 9 October 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

¹⁹⁹ *Ibid.*

²⁰⁰ Lashkina, Elena: "Gazovoe peremirie (Газовое перемирие)", *Rosii'skaia Gazeta*, 10 October 2007 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

²⁰¹ Grib, Natali'a, Netreba, Petr and Gavrish, Oleg: "Iuliu Timoshenko lishili prem'erskoi' doli (Юлию Тимошенко лишили премьерской доли)", *Kommersant*, 10 October 2007 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

²⁰² *Ibid.*

A complex barter scheme was indeed devised between RosUkrEnergo and Gazprom, which in fact left a volume of gas equivalent to US\$1.2bill in deposit as a guarantee for the debt.²⁰³ The Russian daily *Nezavisimaia Gazeta* then rightly suspected the Russian Prime Minister was wrong,²⁰⁴ as President Putin kept mentioning only US\$1.3bill.²⁰⁵ However, the figure of US\$929mill Zubkov had mentioned was real and represented the exact debt owed to RosUkrEnergo by UkrGazEnergo. This figure came after it was revealed that US\$100tcm had been already paid by October 1st, which reduced UkrGazEnergo's debt of US\$1.029mill that had accumulated by September.²⁰⁶ An additional US\$200mill were to be paid by 22nd October 2007.²⁰⁷ During his trip back from Moscow, the Ukrainian Minister of Energy clarified how the scheme to transfer gas between RosUkrEnergo and Gazprom would work: 4bcm which RosUkrEnergo had marked for export would be sold to Gazprom at US\$156tcm; Boi'ko calculated that this sale would bring RosUkrEnergo US\$1.3bill, which nearly matched the outstanding debt.²⁰⁸ If adding 4.5bcm that UkrGazEnergo returned to Gazprom, presumably at the price of US\$130tcm,²⁰⁹ this made up the sum of 8-8.5bcm that was being mentioned.²¹⁰ It must not be forgotten that these volumes were transferred transitorily as a guarantee in case payments in cash were not made and the debt remained unsolved. Otherwise, these transactions would not take place. In addition to it, it was announced that Gazprom would pay Naftohaz in advance for transit tariffs.²¹¹ That would enable the latter to solve its immediate debt problems.²¹²

²⁰³ *Ibid.* Another article in *Trud* surmised this gas would actually be fully acquired by GazExport and then exported (Viktorov, "Prem'ery pogasili", *op. cit.*).

²⁰⁴ Firskova, Anna and Samedova, Evlaliia: "Prem'erskaia nadvadka (премьерская надвадка)", *Gazeta*, 10 October 2007 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

²⁰⁵ Alexandrova, Liudmila: "Solution of gas debt issue poses problems for Ukraine's future govt", *Itar-Tass*, 10 October 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁰⁶ Mazneva, Elena: "Putanitsa v gazovom dolge (Путаница в газовом долге)", *Vedomosti*, 10 October 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁰⁷ *Ibid.*

²⁰⁸ "Boi'ko opisal khitromudruu skhemu, po kotoroi' ukrainsy budut s gazom (Бойко описал хитромудрую схему, по которой украинцы будут с газом)", *Ukrainskaia Pravda*, 10 October 2007, at <http://www.pravda.com.ua/rus/news/2007/10/10/4425551/> (Accessed on the 16th January 2013).

²⁰⁹ "RosUkrEnergo otdest gaz, chtoby potom zaplatit' za nego dorozhe (RosUkrEnergo отдаст газ, чтобы потом заплатить за него дороже?)", *Ukrainskaia Pravda*, 10 October 2007, at <http://www.pravda.com.ua/rus/news/2007/10/10/4425592/> (Accessed on the 29th September 2014). The article identifies the sale price of US\$130tcm for RosUkrEnergo's gas, but this is probably wrong, as US\$130tcm, the price agreed for Ukraine, is what UkrGazEnergo charged in its domestic sales for Central Asian gas.

²¹⁰ "Boi'ko opisal", *op. cit.*; Alexandrova: "Solution of gas debt issue", *op. cit.* The Ukrainian expert Nikolai' Sivil'skii', interviewed by *Moskovskii' Konsomolets*, preferred different figures: between 30bcm and 32bcm, from which 17.8bcm were Ukrainian if Russian buffer gas is discounted (Bazak, Oleg: "Viktor davit na gaz (виктор давит на газ)", *Moskovskii' Konsomolets*, 10 October 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²¹¹ Grib, Natal'ia and Gavrish, Oleg: "'Gazprom' oplatit dolgi 'Naftogaza Ukrainy' ('Газпром' оплатит долги 'Нафтогаза Украины')", *Kommersant*, 16 October 2007 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

²¹² *Ibid.*

In the next days the debt issue evolved satisfactorily. A first batch of US\$200tcm owed to RosUkrEnergo was paid on time,²¹³ and the remainder of US\$729mill was transferred by the deadline of 31st October.²¹⁴ Debts between UkrGazEnergo and RosUkrEnergo also seemed to be fully settled by 6th November 2007.²¹⁵ However, problems still persisted, as the origin of money for the final batch raised a good deal of confusion: US\$500mill came from transfers made by Gazprom to Naftohaz in concept of advanced payments of transit tariffs as announced earlier; US\$170mill came directly from UkrGazEnergo; a minor sum of US\$60mill was paid by Naftohaz owing to a loan from UkrGazEnergo.²¹⁶ The Russian daily *Nezavisimaia Gazeta* explained the complex chain of payments as follows: Naftohaz owed UkrGazEnergo a total of US\$680mill, so adding this to the US\$249mill the latter also owed, RosUkrEnergo would receive a payment of US\$929mill. Then RosUkrEnergo would transfer to Gazprom the total sum of more than US\$1.2bill after adding its own debt to Gazprom totaling US\$317mill.²¹⁷

The sequence of events obviously provided ground for new speculations on allegedly spurious Russian motivations, and it is reasonable to suspect that had a "friendly" government held the upper hand in the latest Ukrainian parliamentary elections, Russia could have been more tolerant. That said, this does not clarify whether Russia was acting for purely political reasons, for the sake of undermining Timoshenko's future government, or whether it wanted to secure the payment of the debt before Timoshenko became Prime Minister. The latter's statements in fact made clear she endeavored to put an end to the existence of intermediaries between Russia and Ukraine.²¹⁸ If we are to follow the assessment by *Vedomosti* and *Trud*, these prospects arguably worried Russia for the consequences this might have on debt repayment if the new government stepped in and waived any responsibility.²¹⁹ Gazprom's latest

²¹³ "RosUkrEnergo receives US\$200mill for gas supplied to Ukraine", *Itar-Tass*, 18 October 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²¹⁴ "Ukraine pays off debt to Russian gas supplies", *Itar-Tass*, 31 October 2007 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²¹⁵ "Rosukrenergo fully clear debt for Gazprom's gas exports", *Itar-Tass*, 7 November 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²¹⁶ Grivach, Alexei': "Voi'na otkladyvaetsia (Война откладывается)", *Vremia Novostei'*, 1 November 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²¹⁷ Gavshina, Oksana: "Ul'timatum Boi'ko (ультиматум бойко)", *Novaia Gazeta*, 31 October 2007 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

²¹⁸ Kapustin, "Gazovoe poslevkusie", *op. cit.*

²¹⁹ Grivach, "Poka prem'er", *op. cit.* Viktorov, Viktor: "za gaz zaplatiat no ne dengami (за газ заплатят но не денгами)", *Trud*, 9 October 2007 (Accessed on the 22nd August 2011, from East View, Harvard Libraries). Alexei' Grivach saw this "insurance" motivation in the paying scheme that secured 8bcm of gas belonging to RusUkrEnergo until payments were guaranteed (see: Grivach, Alexei': "'Oranzhevaia" strakhovka ("Оранжевая" страховка)", *Vedomosti*, 11 October 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries); this, according to Naftohaz sources, as relayed by *Novaia Gazeta*, was also thought on the Ukrainian side (see: Ivzhenko, Tat'iana: "Amerikantsy speshchat na pomoshch' (американцы спешат на помощь)", *Novaia Gazeta*, 12 October 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries). For Timoshenko's intentions, see: Vas'kovskaia, Ianina: "Sekret Chernomyrdina (секрет черномырдина)", *Novaia Gazeta*, 11 October 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

actions could respond to a preventive move to secure payments before Timoshenko could use the debt as a weapon against RosUkrEnergo.

New price hikes from Turkmenistan

In parallel with the debt dispute, news came again from Turkmenistan regarding new price hikes. Turkmenistan allegedly demanded 50% more than the current US\$100tcm.²²⁰ Gazprom did not provide any details, just declaring that prices for Ukraine would be fair.²²¹ In a meeting taking place on 9th of October, it was agreed that transit tariffs would not move from the current tariff of US\$1.6tcm/100km.²²² Prices for 2008 were not discussed yet. The Ukrainian Presidency aimed at securing prices no higher than US\$160tcm for the next year,²²³ as had been already calculated in the budget for 2008.²²⁴

In the following days, Gazprom stated that depending on negotiations with Turkmenistan, US\$180tcm (See ft. 224) might be the price Ukraine would end up paying in 2008.²²⁵ At the beginning of November, Yanukovich, still acting Prime Minister, declared that he would consider acceptable a price ranging from US\$150tcm to US\$160tcm.²²⁶ This was the price which the acting Minister of Energy Iurii' Boi'ko most likely proposed in the latest round of negotiations in Russia in early November.²²⁷ However, on 25th November Gazprom agreed with Turkmenistan to hike prices to US\$130tcm in the first half of 2008, and US\$150tcm in the second half.²²⁸ In exchange for this, Turkmenistan pledged to build a pipeline along the Caspian coast that would direct supplies towards Russia.²²⁹ In spite of this defeat, the Ukrainian side quickly acquiesced in exchange for being compensated by a slightly higher transit tariff,

²²⁰ Shvedov, Petr: "Kiev snova ne platit za nash gaz (Киев снова не платит за наш газ)", *Izvestiia*, 4 October 2007 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

²²¹ "Gazprom obeshchaet spravedlivye tseny (Газпром обещает Украине справедливые цены)", *Ukrainska Pravda*, 7 October 2007, at <http://www.pravda.com.ua/rus/news/2007/10/7/4425403/> (Accessed on the 16th January 2013).

²²² Viktorov, "za gaz zaplatiat", *op. cit.*

²²³ Lakshina, "Gazovoe peremirie", *op. cit.*

²²⁴ Firskova and Samedova, "Prem'erskaia nadvadka", *op. cit.* Some analysts talked already of possible prices up to as much as US\$180tcm (*Ibid.*) and as stated by the Ukrainian Minister of Economy, Anatolii' Kinakh, this would be the threshold over which Ukrainian economy would lose competitiveness (see: Alexandrova, "Solution of gas debt issue", *op. cit.*)

²²⁵ Gavshina, Oksana: "'Naftogaz' zhdet avanza za tranzit (нафтогаз ждёт аванса за транзит)", 24 October 2007 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

²²⁶ Grivach, "Voi'na otkladyvaetsia", *op. cit.*

²²⁷ Grib, Natal'ia: "Rosukrenergo vernul dolgi 'Gazpromu' (Rosukrenergo вернул долги 'Газпрому')", *Kommersant*, 7 November 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²²⁸ Medetskii', Anatolii': "Turkmens tack on 2nd gas price hike", *The Moscow Times*, 28 November 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²²⁹ *Ibid.* It was reported, to Ukraine's dismay, that Russia had rather speedily acquiesced to Turkmen price proposal, as otherwise Russia would have seen Turkmenistan direct additional supplies across the Caspian Sea, following alternative plans to bypass Russia (Nabucco) (see, Grivach, Alexei': "Shantazh umesten (Шантаж уместен)", *Vremia Novostei'*, 29 November 2007 (Accessed on the 24th August 2011, from East View, Harvard Libraries). For more details on the pipeline project, see: Grivach, Alexei': "Putin forsiruet Prikaspii'skuiu trubu (Путин форсирует Прикаспийскую трубу)", *Vremia Novostei'*, 11 December 2007 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

US\$1.7tcm/100km, applied not only to Russian supplies through Ukraine but also to supplies from Central Asia. It was determined that the exact price at the Ukrainian border for 2008 would be US\$179.5/cm.²³⁰

Coincidences between Russia and the new Ukrainian government as for intermediaries

In the last months of 2007 there were hints at an unexpected coincidence in interests between Russia and Ukraine which included not only the acting government but also the incoming government of Timoshenko: Suddenly both Russia and Ukraine expressed their preference for establishing strictly bilateral relations between Gazprom and Naftohaz. Timoshenko's interest in ridding Ukraine of any intermediaries was well known and she abundantly expressed her intentions on the eve of becoming Prime Minister for the second time. However, Dmitri Medvedev, at the time Russian Vice-Prime Minister and Chairman of the Board of Directors of Gazprom, was the one who expressed this more clearly: *"We will most probably revise in the next year the terms of our mutual relationship and put an end to the existence of any intermediaries which cannot be properly explained"*.²³¹

These statements were welcomed by the acting Ukrainian Minister of Finance Mykola Azarov (who was not related to Dmitro Firtash as his Minister of Energy Iurii' Boi'ko),²³² and were also, as could have been reasonably expected, by Iulia Timoshenko herself.²³³ Dmitri Medvedev reiterated Gazprom's preference for direct relations without intermediaries in mid-November, although somehow subtly leaving the decision to the Ukrainian side.²³⁴ Still, Gazprom did not agree with further suggestions to return to the barter system that prevailed before the agreement of January 2006, as had been put forward from the "Orange" camp.²³⁵ This timid exchange prefigured what would eventually happen in the coming months, with both points of convergence, but more importantly, divergence too.

²³⁰ "Gazprom, Ukraine agree on new gas price of nearly 180 dlr", *Itar-Tass*, 4 December 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²³¹ Grivach, Alexei': "Oboi'demsia bez posrednikov (Обойдемся без посредников)", *Vremia Novostei'*, 16 October 2007 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²³² Elder, Miriam: "Gazprom may sell gas direct to Kiev", *The Moscow Times*, 17 October 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries); "Azarov gotov otkazat'sia ot RosUkrEnergo (Азаров готов отказаться от РосУкрЭнерго)", *Ukrainskaia Pravda*, 16 October 2007, at <http://www.pravda.com.ua/rus/news/2007/10/16/4425886/> (Accessed on the 22nd January 2013).

²³³ Grivach, Alexei': "Podarok dlia Timoshenko (Подарок для Тимошенко)", *Vremia Novostei'*, 17 October 2007 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

²³⁴ "Gazprom doubts expediency of RosUkrEnergo in gas supply", *Itar-Tass*, 20 November 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²³⁵ Grib, Natal'ia and Gavrish, Oleg: "Gaz v obmen na transport (Газ в обмен на транспорт)", *Kommersant*, 23 October 2007 (Accessed on the 23rd August 2011, from East View, Harvard Libraries); Grivach, Alexei': "Nazad k barteru (Назад к бартеру)", *Vremia Novostei'*, 23 October 2007 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

7. 4. Timoshenko Government: New Debt Problems Lead to a Dispute

In spite of the resolution of the debt dispute of late 2007, 2008 started with a new one with much worse consequences.

The first element of this new episode was related to winter temperatures in Central Asia which happened to be much lower than usual. As a result, more gas was needed for domestic consumption, so normal supplies for Ukraine decreased in the magnitude of a daily 40mcm²³⁶ in mid-January.²³⁷ As supplies were nevertheless guaranteed by RosUkrEnergo, more gas was purchased from Gazprom and no shortages whatsoever had to be reported.²³⁸ The problem however lay in the issue of pricing, as instead of Turkmen gas priced at US\$179.5tcm, Russian gas costing US\$314.7tcm had to be used as a complement.²³⁹ In a sign of the extreme distrust the new Ukrainian government had towards Russian authorities, declarations from the Executive Director of RosUkrEnergo exposing the situation and mentioning the price the company was paying for additional Russian gas were interpreted as a measure of pressure on Ukraine.²⁴⁰

The second element was an (already) classic episode of debt accruing through the complex web of relations between Naftohaz, UkrGazEnergo, RosUkrEnergo and Gazprom. As some months ago, UkrGazEnergo was indebted again to RosUkrEnergo, by a figure of around US\$830mill.²⁴¹ A tentative explanation for this new incident was given, which identified additional amounts of gas that had been pumped from RosUkrEnergo's storage facilities by UkrGazEnergo as the origin of the debt,²⁴² officially this had been intended to ensure supplies for the next heating season 2008-09.²⁴³ In any case

²³⁶ According to Illia Ribchich, Head of "Ukrgazdobycha" until 2004, in a recent interview, minimum domestic consumption of gas in winter is around 240mcm per day, peaking at 320-350mcm under extreme temperatures (see: Kuion, Sergii': "Illia Ribchich: Zimu mozhna proiti bez rosii's'kogo gazu (Ілля Рибчич: Зиму можна пройти без російського газу), *Ekonomichna Pravda*, 4 September 2014, at <http://www.epravda.com.ua/publications/2014/09/4/488069/> (Accessed on the 30th September 2014).

²³⁷ "Gazprom confirms gas supplies to RosUkrEnergo" *Itar-Tass*, 16 January 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²³⁸ *Ibid.*

²³⁹ "RosUkrEnergo buys Russian gas at USD 314 per 1,000 cm in Jan 2008", *Itar-Tass*, 16 January 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁴⁰ Kashin, Vasilii': "Voi'na nervov (Война нервов)", *Vedomosti*, 17 January 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁴¹ "UkrGaz - Energo promises to repay debt to RosUkrEnergo", *Itar-Tass*, 17 January 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁴² *Ibid.*

²⁴³ Grib, Natal'ia and Gavrish, Oleg: "Ukraina i Rossiia zaniiali gazovye pozitsii (Украина и Россия заняли газовые позиции)", *Kommersant*, 18 January 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

UkrGazEnergo had not been able to pay yet. In another similarity to the debt dispute of October 2007, there also seemed to be a sum of US\$1.2bill which Naftohaz owed to UkrGazEnergo.²⁴⁴

First reactions by the Ukrainian authorities bode ill for the outcome of this new dispute. As feared by Gazprom (see previous section), the existence of this debt was used as an occasion to revise the status quo in general and the presence of intermediaries in particular. The Energy market regulator swiftly ordered an investigation of UkrGazEnergo.²⁴⁵ At the same time, former Minister of Energy, Iurii´ Boi´ko, tried to defend the record of Naftohaz under his management,²⁴⁶ now also under scrutiny. Naftohaz had been already investigated some days before as it was suspected of being on the brink of bankruptcy.²⁴⁷ With Naftohaz allegedly having torn up early negotiations to solve the debt problem in the face of disagreements with RosUkrEnergo,²⁴⁸ the road ahead promised to be rough.

New data were soon released, where a more detailed breakdown of the debt was provided: UkrGazEnergo owed US\$598mill to RosUkrEnergo and Naftohaz owed US\$215mill to UkrGazEnergo.²⁴⁹ This figures, as so often happened, did not match earlier reports. As reported some months later by *Nezavisimaia Gazeta* from sources within Naftohaz, it was suspected that intermediaries had intentionally failed to undertake the normal procedures for payments, leading to this new debt episode. This would have been used as a means of pressure against a new government which barely concealed its intention to remove any intermediary.²⁵⁰ Compounding this new debt dispute, the new leadership in Ukraine was putting forward far-reaching changes that necessarily put it at odds with Russia.

The new Timoshenko government tries to revise current energy relations

In the first place, the new government wanted to revise the pricing agreements of December 2007. Its intention was to review the transit tariff of US\$1.7tcm/100km, the first proposal voiced being an

²⁴⁴ *Ibid.*

²⁴⁵ "Ukraine to investigate UkrGaz-Energo", *Dow Jones*, 21 January 2008.

²⁴⁶ "Ukraine has no gas debt at Jan 1, 2008 - ex - energy minister", *Itar-Tass*, 22 January 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁴⁷ Beliiakov, Evgenii´: "V poiskakh raskhititelei´ gaza (в поисках расхитителей газа)", *Gazeta*, 10 January 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries). According to Ernst &Young, in charge of auditing Naftohaz's financial situation, debts started in 2005, mainly as a consequence of the government's decisions (headed by Ms. Timoshenko) to raise taxes and to forbid re-exports of natural gas (*Ibid.*).

²⁴⁸ Ivzhenko, Tat´iana and Shcheglov, Alexei´: "'RosUkrEnergo" zakhodit s tyla ("РосУкрЕнегро" заходит с тыла)", *Nezavisimaia Gazeta*, 28 January 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁴⁹ *Ibid.*

²⁵⁰ Ivzhenko, Tat´iana: "Uspeshnye peregovory zashli v tupik (УСПЕШНЫЕ ПЕРЕГОВОРЫ ЗАШЛИ В ТУПИК)", *Nezavisimaia Gazeta*, 24 November 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

extremely steep increase to no less than US\$9.32tcm/100km.²⁵¹ None of this was mentioned in the first meeting between Alexei Miller and his new counterpart Oleg Dubina, but the latter nevertheless insisted on revising the tariffs.²⁵² The expressed reason for this was that Naftohaz needed to offset the impact of increasing gas prices. However, Miller did not meet Dubina's expectations and reversed the argument, explaining that higher transit tariffs would in fact translate into even higher prices. The baseline for Miller's argumentation was that US\$179.5tcm was a much lower price than market prices charged to Europe close to US\$314.7tcm.²⁵³

This discussion was the occasion for a new factor that was to play a significant role in the upcoming dispute of March 2008: divergences within Ukrainian politicians belonging to the Orange coalition. The Ukrainian President Viktor Yushchenko, now one of the most bitter foes of his Prime Minister, decided to intervene in the ongoing discussions by drawing the National Security and Defense Council, under his control, into the debates on energy policy.²⁵⁴ Thus, Yushchenko surprisingly expressed his disagreement with the government and opposed any change to the transit tariff. In his understanding, Ukraine also benefited from this low tariff in the sense that it was also charged on Central Asian gas transiting to Ukraine through Russia and did not allow Timoshenko to perform a planned trip to Russia to pursue her policy.²⁵⁵ Yushchenko was aligning himself with Alexei Grivach's arguments, who wrote in *Vremia Novosti*, that Kiev actually benefited more than Russia in terms of earnings, as both the volume of Russian gas and the transit distance through Ukraine were bigger than Central Asian gas for Ukraine transiting Russia.²⁵⁶ This led Ukraine to earn four times more than Russia, and while European countries usually charged bigger transit tariffs, the difference laid mostly in the fact that this was charged on gas priced following market mechanisms.²⁵⁷

²⁵¹ Reznik, Irina: "Dubin gozovoi' voi'ny (дубин газової війни)", *Gazeta*, 18 January 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

²⁵² Grib and Gavrish, "Ukraina i Rossiia zaniiali", *op. cit.* As the analyst Mikhail Korchemkin pointed out, it seemed odd to purchase gas during the previous season and not at the very end of it, when prices would go down (see: *Ibid*).

²⁵³ *Ibid*.

²⁵⁴ Grivach, Alexei': "Natsional'naia oborona po-ukrainski (Национальная оборона по-украински)", *Vremia Novosti*, 23 January 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁵⁵ Grivach, Alexei': "Timoshenko ishchet argumenty (Тимошенко ищет аргументы)", *Vremia Novosti*, 24 January 2008 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

²⁵⁶ *Ibid*.

²⁵⁷ *Ibid*. It could be argued that whereas a lower tariff of US\$1.7/tcm/100km was suited for gas from Central Asia priced at US\$179.5tcm, Russian gas sold at market prices transiting Ukraine could have been rightfully charged a "market" tariff too. This would however disregard the fact that after all, Ukraine received a bigger share of cheaper Central Asian gas as a result of the January 2006 agreements and that all gas was primarily purchased by Gazprom; Gazprom could in theory force Ukraine to purchase a bigger share of Russian gas at higher prices and then re-export to its sole benefit Central Asian gas abroad. This has not been an easy discussion indeed, as for example Alla Eremenko from *Zerkalo Nedeli* stated that real transit tariffs in European countries did in fact range at prices similar to US\$9,32tcm/100km as proposed by the new government. A report by the Energy Charter of 2006 showed that Ukrainian tariffs were lower than in many other East European countries, but neither

Secondly, the new government, as already known, wanted to eliminate intermediaries. Besides economic reasons, political aversion of Timoshenko to her antagonist Dmitro Firtash played a major role. Thus, in the above mentioned meeting with Miller, Dubina made clear the government's intention to seize full control of the internal gas market and to reduce the share of UkrGazEnergo to 7% from 70% the company controlled so far.²⁵⁸ The rift between the President and his Prime Minister cast some shadows on the government's margin of action in this area too. In fact, Yushchenko's position on transit tariffs came at the moment when scandal broke out regarding the President's family's alleged corrupt links to UkrGazEnergo.²⁵⁹ Timoshenko was quick to make the link between the recently detained Semion Mogilevich and Dmitro Firtash himself, who was very often linked to him,²⁶⁰ to make the case in her campaign for transparency in energy trade,²⁶¹ and as it had happened before, signs from Russia were positive: Valerii Draganov, Deputy Chairman of the State Duma's Energy Committee, accepted in principle the establishment of direct relations.²⁶² the Vice-Speaker of the State Duma, Valerii Iazev went in the same direction when he stated that *"The less intermediaries in such major projects the better (...) Russia has repeatedly said that it would be right if founders of this joint venture were Gazprom and Naftohaz Ukrainy"*.²⁶³

So paradoxically when there was at least a certain convergence between Ukraine's and Russia's interests, more than external, it was internal obstacles that came in Timoshenko's way. Her unilateral decision to restrict UkrGazEnergo to a market share of only 5.04bcm per year was cancelled by a

of these charged anything similar to US\$9tcm/100km; if applying the report's nominal values in order to assess different pricing systems, Ukraine was accorded 28 (US\$1.09tcm/100km) while as Simon Pirani calculated, 41 should be the value in accordance to US\$1,60tcm/100km, whereas the highest tariff paid in Austria, was 96 (see: "Gas transit charges: in selected Energy Charter countries", Energy Charter (January 2006), at

http://www.encharter.org/fileadmin/user_upload/document/Gas_Transit_Tariffs_-_2006_-_ENG.pdf; Pirani, "Ukraine's Gas Sector", *op. cit.*, pp. 84-85; these two documents are discussed in: Stege, Hans: "More on Ukraine's gas transit tariff issue", *Kremlin Inc.* (23 January 2008), at <http://kremlininc.wordpress.com/2008/01/23/more-on-ukraines-gas-transit-tariff-issue/>.

²⁵⁸ Grib and Gavrish, "Ukraina y Rossiia zaniiali", *op. cit.*

²⁵⁹ See: Grib, Natal'ia; Solov'ev, Vladimir and Gavrish, Oleg: "Viktora Iushchenko traviat gazom (Виктора Ющенко травят газом)", *Kommersant*, 16 January 2008; we dealt with this in the previous chapter, pp. 62-63, and ft. 326.

²⁶⁰ Something that was repeatedly denied by Firtash (see: Reznik: "'Eto nereal'naia, fantasticheskaiia skhema", - Dmitrii Firtash, sovladelets Rosukrenergo («Это нереальная, фантастическая схема», - Дмитрий Фирташ, совладелец Rosukrenergo), *Vedomosti*, 28 January 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries); see also: Zygar', Mikhail and Naiem, Mustafa: "Gazovyi ben Laden (Газовый бен Ладен)", *Kommersant*, 4 February 2008 (Accessed on the 27th August 2011, from East View, Harvard Libraries); Shlei'nov, Roman: "Govoriat, kosmetika. podrazumevaiut gaz (говорят, косметика. подразумевают газ)", *Novaia Gazeta*, 4 February 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁶¹ Medetskii', Anatolii': "Tymoshenko sees new transparency", *The Moscow Times*, 29 January 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

²⁶² "RosUkrEnergo gas trade mediator may be abolished – Draganov", *Itar-Tass*, 1 February 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁶³ "Russia - Ukraine direct gas supply accord possible – Yazev", *Itar-Tass*, 1 February 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

judiciary decision.²⁶⁴ After a meeting with the National Security and Defense Council the President approved the removal of RosUkrEnergo but only progressively, so as to avoid destabilizing the energy market.²⁶⁵ This ran counter to the more radical agenda of Timoshenko, who some days later launched a new attack on the company saying that RosUkrEnergo had not been supplying gas since November 2007, forcing Naftohaz to use its own reserves instead.

This in fact was totally false. Quite the contrary, it was Naftohaz who had not registered its purchases with UkrGazEnergo, thus letting a significant debt build up.²⁶⁶ Timoshenko targeted both intermediaries, but sometimes in quite haphazard ways, as when she proposed RosUkrEnergo to bypass UkrGazEnergo altogether.²⁶⁷ However, some days later, the cabinet was reportedly preparing a similar move, this time targeting RosUkrEnergo instead, in order to establish direct relations between Naftohaz and Gazprom.²⁶⁸

Gazprom Threatens to Cut Supplies and Yushchenko Temporarily Finds a Truce

Timoshenko's drive to revise the current status quo and the new debt issue revealed itself as an explosive combination.

To begin with, when the debt of Naftohaz to UkrGazEnergo (and which affected Gazprom) by early February was revealed and quantified by a member of the board of trustees of the latter company to be as much as US\$1.5bill,²⁶⁹ Gazprom's reaction was immediate and much more assertive than in previous cases: the Russian gas monopoly issued an ultimatum demanding the immediate payment of the

²⁶⁴ Grib, Natal'ia; Mordiusenko, Ol'ga and Gavrish, Oleg: "Ukraina razzhala trubu (Украина разжала трубу)", *Kommersant*, 1 February 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries). Vadim Karasev, director of the Institute of Global Strategy (Kiev) saw this as a victory for the side of Yushchenko against more extreme plans by Timoshenko.

²⁶⁵ Grivach, Alexei': "Na raznykh iazykakh (На разных языках)", *Vremia Novostei*, 4 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries); Ivzhenko, Tat'iana: "Timoshenko svoego dobilas' (тимощенко своего добила)", *Nezavisimaia Gazeta*, 4 February 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁶⁶ Grivach, Alexei': "Podryvnaia deiatel'nost' (Подрывная деятельность)", *Vremia Novostei*, 5 February 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries); Reznik, Irina and Kashin Vasili': "Neopoznannyi' gaz (Неопознанный газ)", *Kommersant*, 6 February 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁶⁷ Reznik and Kashin, "Neopoznannyi' gaz", *op. cit.*

²⁶⁸ "Interfaks: "Ukraina gotovit priamye zakupki gaza" (Interfaks: "Украина готовит прямые закупки газа")", *Vedomosti*, 7 February 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

²⁶⁹ "Executive says Ukraine's gas copr owes over 1 bln dlrs importers for nat gas", *Itar-Tass*, 7 February 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries). Aleksandr Gudyma, energy advisor to the Prime Minister, explained debts accruing from non-payments for November and December as the result of alleged attempts to extract 2008 instead of 2007 prices (Reznik, Irina and Kashin, Vasili': "Dym nad vodoi' (Дым над водой)", *Vedomosti*, 8 February 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

outstanding debt, fixing the 11th of February as the final deadline; otherwise gas supplies to Ukraine would be stopped.²⁷⁰

Confusion still prevailed regarding the exact volume of the debt and its relation to non-payments from the side of Naftohaz to UkrGazEnergo and to the additional purchase of more expensive Russian gas, which by 6th February amounted to 1.5bcm.²⁷¹ As it seemed, US\$500mill accrued from RosUkrEnergo's purchase of Russian gas, while the remaining sum of US\$1bill resulted from Naftohaz's non-payments to UkrGazEnergo for regular supplies.²⁷² An initial confusion also concerned which supplies Gazprom was to cut in case of non-payment, as it seemed from Sergei' Kuprianov's statement (Gazprom's Spokesman), that only additional Russian supplies were targeted.²⁷³ In that case the threat to Ukraine's energy security was not so significant.²⁷⁴ However, Alexei' Miller soon warned that supply of Central Asian gas was also included in the prospective cut-off.²⁷⁵

Vremia Novostei' on 8th February provided more detailed information on the breakdown of the debt: Naftohaz owed US\$400-500mill for Central Asian gas not paid in late 2007, a further sum of US\$370mill corresponded to gas supplied in January, while in addition, there was an officially acknowledged debt of US\$250mill to UkrGazEnergo. The whole debt to UkrGazEnergo was said to amount to US\$600mill by mid-January, resulting in a final debt of US\$1.023mill owed by RosUkrEnergo to Gazprom. The Executive Director of Naftohaz, Igor' Didenko, had earlier surmised that debt to RosUkrEnergo had its origin in the former leadership's artificial accumulation of debt with the political goal of burdening the upcoming government.²⁷⁶

What could account for Russia's reaction being so harsh? More than the volume of the debt itself, this could be related to the intentions to remove RosUkrEnergo.²⁷⁷ As Mikhail Korchemkin assessed, Gazprom's reaction was related to its fear of losing gas that RosUkrEnergo owed, in case the company

²⁷⁰ "Gazprom may end gas supplies, Ukraine must pay debt by Mon", *Itar-Tass*, 7 February 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

²⁷¹ Pavlovich, Dmitrii': "'Gazprom" gotov ostavit' ukrainu bez gaza ("газпром" готов оставить Украину без газа)", *Gazeta*, 8 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁷² Grib, Natal'ia and Gavrish, Oleg: "Otkliuchenie, podtverzhdaushchee pravilo (Отключение, подтверждающее правило)", *Kommersant*, 8 February 2008 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

²⁷³ See: Pavlovich, "'Gazprom" gotov", *op. cit.*; "Gazprom leader hopes for successful talks with Ukraine", *Itar-Tass*, 8 February 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁷⁴ Grivach, Alexei': "Vyzov priniat (Вызов принят)", *Vremia Novostei'*, 8 February 2008 (Accessed on the 9th August 2011, from East View, Harvard Libraries).

²⁷⁵ Grivach, Alexei': "Esli zavtra voi'na (Если завтра война)", *Vremia Novostei'*, 11 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁷⁶ Vas'kovskaia, Ianina: "otkuda vziasia ukrainskii' dolg "Gazpromu" (откуда взялся украинский долг "газпрому)", *Novaia Gazeta*, 11 February 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁷⁷ Grib and Gavrish, "Otkliuchenie", *op. cit.*

was unilaterally removed.²⁷⁸ Naftohaz's and the Prime Minister's negotiating position consisted in systematically denying accusations, blame intermediaries instead and finally accept the debt on condition that intermediaries were removed.²⁷⁹ Vice-Prime Minister Oleg Turchinov made this strategy very clear: debt problems could be solved only if contracts were signed directly with Gazprom and RosUkrEnergo removed in the process.²⁸⁰ This did not put Gazprom in an easy position. When Igor' Didenko and his Russian counterpart Valerii' Golubevii' met, Naftohaz proposed to sign a direct contract on the basis of US\$179.5bcm, including not only Central Asian, but more expensive Russian gas too;²⁸¹ the exact mechanism to pay back debts as proposed by the Ukrainian monopoly, was to do it through a loan from Deutsche Bank to be repaid in the next seven to eight weeks.²⁸² This was utterly rejected by Gazprom.

However, the situation took an unexpected turn on 12th February 2008 when Yushchenko met with his Russian counterpart Vladimir Putin. A meeting the day before between Oleg Dubina and Alexei' Miller had led to the postponement of the deadline to 18:00pm of the next day. That left enough time for the presidents to find a temporary solution: debt from 2007 would be repaid from Thursday 14th at prices (as seemed obvious) equivalent to those agreed for the year before.²⁸³ A first batch of US\$100mill would be paid,²⁸⁴ with a second payment of US\$178mill to UkrGazEnergo to follow on 20th February.²⁸⁵ The

²⁷⁸ Reznik and Kashin, "Dym nad", *op. cit.* Korchemkin meant the gas that Gazprom had received from RosUkrEnergo (he talked of 12bcm) as a deposit to ensure the payment of debts.

²⁷⁹ A good example of the denial tactic was Naftogaz's statement that an additional 1.5bill of Russian gas had been in fact exported by RosUkrEnergo; Naftohaz accused RosUkrEnergo to pretend it assumes the costs of these volumes as if they had been consumed within Ukraine (the latest being in fact, true): Grib, Natal'ia: "'Gazprom' privel ventili v boegotovnost'" ("Газпром" привел вентили в боеготовность)", *Kommersant*, 9 February 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries). In an interview to *Zerkalo Nedeli*, Naftohaz's new Head, Oleg Dubina, supported this version and also blamed UkrGazEnergo for not having signed the documents for supply, for which it was responsible (see: Eremenko, Alla: "Zadacha s zolotymi trubami i dyriavym bassei'nom (Задача с золотыми трубами и дырявым бассейном)", *Zerkalo Nedeli*, 8 February 2008, at http://gazeta.zn.ua/POLITICS/zadacha_s_zolotymi_trubami_i_dyryavym_basseynom.html (Accessed on the 12th June 2015) For the conditionality tactic, see: Kezik, Irina: Stop kran (стоп кран), *Gazeta*, 11 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries). Whatever tactic was used in order to blame intermediaries and to make thus the case for their removal. An example is for example, when Prime Minister Timoshenko accused RosUkrEnergo to be charging gas from November and December at 2008 and not 2007 prices, thus swelling artificially the debt (see: Elder, Miriam: "Gas talks come down to the wire", *The Moscow Times*, 12 February 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries); Grib, Natal'ia and Gavrish, Oleg: "Iuliia Timoshenko nachala likvidatsiiu "UkrGaz-Energo" (Юлия Тимошенко начала ликвидацию "Укргаз-Энерго")", *Kommersant*, 7 February 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

²⁸⁰ Mazneva, Elena and Kashin, Vasilii': "'Dochka' v otkliuchke («Дочка» в отключке)", *Vedomosti*, 11 February 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

²⁸¹ Grivach, "Esli zavtra", *op. cit.*

²⁸² Korets, Marina: "Gazprom" zakruchivaet tsenu ("газпром" закручивает цену)", *Trud*, 12 February 2008 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

²⁸³ Petrov, Gennadii' and Korets, Marina: "Iushchenko poobeshchal ne razmeshchat' voennykh baz na Ukraine (ющенко пообещал не размещать военных баз на украине)", *Trud*, 14 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁸⁴ "Naftogaz Ukrainy settles part of debt for UkrGazEnergo gas", *Itar-Tass*, 14 February 2008 (Accessed on the 27th August 2011, from East View, Harvard Libraries). For more details as to the breakdown of the whole debt between all actors involved

deadline for full payment was set on 14th of March.²⁸⁶ No agreement could be found though, regarding the US\$500mill owed for Russian gas, as Oleg Dubina refused to pay for any Russian gas and refused any of his counterparts' arguments, namely, that deliveries of Russian gas in compensation for undersupply from Central Asia were included in the January 2006 agreement.²⁸⁷

Second, and more importantly, as it partly met the Ukrainian government's wishes, two new joint ventures (JV) jointly owned by Gazprom and Naftohaz would be established instead of RosUkrEnergo and UkrGazEnergo.²⁸⁸ From the Russian side, there was readiness to change intermediaries immediately if there was a guarantee that bills would be duly paid.²⁸⁹ It was understood though, that Gazprom would not risk neither legal problems with RosUkrEnergo nor it would preclude the company from its contracted sales to Europe, which by the way, benefited the Russian monopoly as a means to cover debts.²⁹⁰ The transition for the suppression of RosUkrEnergo promised thus to be progressive one. Sources from Naftohaz themselves admitted it would be difficult to introduce any changes before 2009, as volumes were already contracted for the whole year.²⁹¹ However, UkrGazEnergo would be substituted earlier.²⁹² A deadline was set for April 1st to establish the new scheme for gas delivery and to agree on the two new JV.²⁹³

At first sight, it seemed that the presidential agreement went in line with Timoshenko's policy. With the Prime Minister proposing on the eve of the meeting that Naftohaz should pay for the US\$1bill

in the energy market of Ukraine, see: Grivach, Alexei': "Gruppy po interesam (Группы по интересам)", *Vremia Novostei*, 15 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁸⁵ "Naftogaz Ukrainy transfers USD178 mln to UkrGazEnergo", *Itar-Tass*, 20 February 2008 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

²⁸⁶ Grib, Natal'ia and Gavrish, Oleg: "'Gazprom" dal Ukraine poltora mesiatsa ("Газпром" дал Украине полтора месяца)", *Kommersant*, 15 February 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

²⁸⁷ Petrov and Korets, "Iushchenko poobeshal", *op. cit.*

²⁸⁸ In a nutshell, private Ukrainian investors would be removed to let Naftohaz take their place, preserving at the same time the 50/50 proportion inherited from RosUkrEnergo (see: Grib, Natal'ia and Gavrish, Oleg: "Operatsiia "Posrednik" (Операция "Посредник")", *Kommersant*, 13 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries). As written by *Neft Rossii* in late 2007, the plan for such a JV was being considered by the government at that time among the options to fulfill the President's order to suppress intermediaries (see: "kto kormitsia ot "RosUkrEnergo" (Кто кормится от "РосУкрЭнегро"?", *Neft Rossii*, 16 October 2007 (Accessed on the 14th February 2013, from Integrum, Helsinki University Libraries).

²⁸⁹ Grivach, Alexei': "'Detenizatsiia" imeni Timoshenko ("Детенизация" имени Тимошенко)", *Vremia Novostei*, 14 February 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

²⁹⁰ Grib, Natal'ia and Gavrish, Oleg: "'Gazprom" otkupitsia ot Rosukrenergo ("Газпром" откупится от Rosukrenergo)", *Kommersant*, 14 February 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁹¹ Vas'kovskaia, Ianina: "Vsem ostavat'sia na mestakh (всем оставаться на местах)", *Novaia Gazeta*, 14 February 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²⁹² Ivzhenko, Tat'iana: "Novoe "Rosukrenergo" khuzhe starogo (новое "росукренерго" хуже старого)", *Nezavisimaia Gazeta*, 14 February 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

²⁹³ Grib and Gavrish, "'Gazprom" dal Ukraine", *op. cit.*

debt (nothing was said about the US\$500mill owed for Russian gas) directly to RosUkrEnergo and skip thus UkrGazEnergo altogether,²⁹⁴ it could be concluded that her objectives were fully satisfied.

However, there was a concession to Gazprom in exchange for the agreement that stood on the way of the Prime Minister's acquiescence: henceforth, Gazprom could increase its share in the internal Ukrainian market for gas imports, from the (indirect) 25% it already had through its participation in UkrGazEnergo, to 50%.²⁹⁵ This was interpreted as a violation of Ukrainian energy sovereignty and fueled the worst speculations regarding Gazprom's intentions.²⁹⁶ For Timoshenko, intermediaries which she made responsible for all the debt accumulated from late 2007 were now being substituted for something much worse: a direct penetration of Gazprom into Ukraine's energy market.²⁹⁷

Prime Minister Yulia Timoshenko takes back the initiative: the road to a new gas dispute

Although the expected liquidation of private intermediaries was in itself very enthusiastically hailed by the Prime Minister,²⁹⁸ the latest agreement nevertheless appeared as Yushchenko's victory at the expense of his Prime Minister. Timoshenko's more radical proposals seemed to have been thwarted in favor of Yushchenko, who could now appear as the peace-maker who extricated Ukraine from a difficult situation, for which Timoshenko could now be held responsible.²⁹⁹ Gains in the Ukrainian political arena made at the expense of the adversary may be the main explanation for this divergence.

²⁹⁴ Grivach, Alexei' and Denisov, Andrei': "Gazovaia missiia (Газовая миссия)", *Vremia Novostei'*, 12 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁹⁵ This was later confirmed in March when President Yushchenko published the agreement and it was also stated that Gazprom's share was to be determined in a range from 25% to 50 % (see: "Grivach, Alexei': "Sovershenno nesekretno (Совершенно несекретно)", *Vremia Novostei'*, 11 March 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

²⁹⁶ Gazprom's objective since many years had been to gain a participation in Ukraine's GTS, whose spirit was best represented in the agreement of 2002 for an International Consortium. This latest agreement did not open the door to such scheme, but it nevertheless raised questions as to whether Gazprom would not use it as a vehicle for enforcing market prices (see the explanations by Iurii' Korovin from "Olgaz-Invest" in Grib and Gavrish, "Operatsiia "Posrednik", *op. cit.*) either for its sake or as a leverage for resurrecting favorable proposals regarding the transportation system; a more defensive motivation, namely to be prepared to face future debt problems, could not be also considered.

²⁹⁷ See: Korets, Marina and Petrov, Evgenii': "Putin-Iushchenko: v nashikh otnosheniakh nakopilos' mnogo voprosov (путин-ющенко: в наших отношениях накопилось много вопросов)", *Trud*, 13 February 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries); Ivzhenko, "Novoe Rosukrenergo", *op. cit.*

²⁹⁸ Grivach, ""Detenizatsiia", *op. cit.*; Elder, Miriam: "New firm at crux of Ukraine gas deal", *Moscow Times*, 14 February 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries). Alexei' Grivach's assessment in the same article concludes that in strict economic terms, Naftohaz comparatively improved its position much more than Gazprom did, the former extracting more benefits from exports to Europe by the new JV, than Gazprom would from the less lucrative Ukrainian internal market. Again we have to consider possible prospective strategic gains from the side of Gazprom with its penetration in the Ukrainian internal market; if Gazprom earned US\$50 mill before, it would then double benefits to US\$100 mill with a 50% quota of the new JV in substitution of UkrGazEnergo (see: Grib and Gavrish, "Iuliia Timoshenko nachala", *op. cit.*).

²⁹⁹ For the internal side of the dispute and the Yushchenko-Timoshenko competition and suspicions as to whether Russia was trying to drive a wedge in the Orange camp, just for the sake of weakening them or even to build support for Yushchenko (other versions talked even of a preference for Timoshenko), see: Odnokolenko, Oleg: "Kto ostalsia na

The fight between Yushchenko and Timoshenko continued in the next days. The Prime Minister was scheduled for a visit to Moscow on 21st February. Yushchenko then thwarted her plans again and went himself instead.³⁰⁰ However, disagreements existed between the Russian and Ukrainian sides regarding the application of the latest agreement: it was proposed from Russia that Naftohaz should buy assets in UkrGazEnergo, while in Ukraine, the preference was to suppress UkrGazEnergo outright and then establish a new JV. At the same time, Gazprom intended that the new JV (where Gazprom presumably would own 50%) should also include Ukrainian gas sold to the population at subsidized prices.³⁰¹ An additional point of contention was whether Naftohaz would recover the right to re-export gas which RosUkrEnergo had assumed in January 2006 in its stead.³⁰² *Ukrainska Pravda* reported the existence of a draft agreement which secured reexport rights for Gazprom Export and which foresaw that the new JV would market all gas supplies in Ukraine, as Gazprom had been demanding.³⁰³ Meanwhile, the controversy of Russian gas supplied since the beginning of the year promised to complicate talks.³⁰⁴

With these disagreements impairing the application of Yushchenko's agreement, a door of opportunity seemed open for Timoshenko to strike back. In fact, her first step was made when she managed to travel to Moscow on 20th February, against the Head of State's wishes and a day before Yushchenko himself.³⁰⁵ This was the beginning of her counteroffensive leading eventually to a short gas dispute. Even before this trip, Naftohaz had already tried to bend Yushchenko's agreements in its favor and proposed to accept price hikes for internal consumers and Gazprom's use of its storage facilities in Ukraine in exchange for the immediate establishment of Gazprom's direct supplies on the basis of

трубе)", *Itogi*, 18 February 2008 (Accessed on the 22th August 2011, from East View, Harvard Libraries); Rubanov, Ivan; Khrabryi, Oleg: "Iz dvukh zol milee predskazuemoe (Из двух зол милее предсказуемое)", *Ekspert*, 18 February 2008 (Accessed on the 22th August 2011, from East View, Harvard Libraries); Grib, Natal'ia and Zygar, Mikhail: "Bazar dlia troikh (Базар для троих)", *Kommersant*, 18 February 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries); Gorevoi, Ruslan: "Sveta i gaza (света и газа)", *Nasha Versiia*, 18 February 2008 (Accessed on the 27th August 2011, from East View, Harvard Libraries); Naiem, Mustafa; Zygar, Mikhail and Grib, Natal'ia: "Iz Iulii Timoshenko vypustili gaz (Из Юлии Тимошенко выпустили газ)", *Kommersant*, 21 February 2008 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

³⁰⁰ Grivach, Alexei: "Prezidenty bez printsessy (Президенты без принцессы)", *Vremia Novostei*, 18 February 2008 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

³⁰¹ Grib and Gavrish, "Gazprom" dal Ukraine", *op. cit.*

³⁰² Grib, Natal'ia: "Ukraina trebuet prava na eksport gaza (Украина требует права на экспорт газа)", *Kommersant*, 18 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries). The whole issue was complicated at least regarding the possibility of a rapid transition and a quick elimination of RosUkrEnergo as intermediary, because Gazprom needed the latter to accomplish its export plans to Europe, from whose earnings it hoped to see outstanding debts from the trader repaid.

³⁰³ Mazneva, Elena and Kashin, Vasilii: "Iushchenko kupit gaz (Ющенко купит газ)", *Vedomosti*, 19 February 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³⁰⁴ It was not known why RosUkrEnergo had decided to import Russian gas and not to make it up with gas of its own stored in Ukraine as in previous occasions (see: Grivach, "Gruppy po interesam", *op. cit.*).

³⁰⁵ Yushchenko was waiting for an informal summit of the CIS on the 22nd while Timoshenko was supposed to come one day before, on the 21st. Yushchenko decided to go on the 21st to substitute her, as already mentioned above, but Timoshenko outsmarted him and also re-scheduled her trip.

US\$179.5tcm (in spite of Russian gas being priced at US\$314.7tcm) while it proposed to extend the deadline for paying the debt to the 1st April from 14th March as agreed earlier.³⁰⁶ However, Vice-Prime Minister Oleksandr Turchinov had already announced that talks should start from a "clean slate". The unrelenting revisionist drive by the government was manifest when the latest proposal by Naftohaz was known: to return the debt due to Gazprom for additional supplies of Russian gas, priced at either US\$130tcm and US\$179.5tcm, depending on whether it had been supplied in 2007 or 2008.³⁰⁷ Naftohaz also referred to the two new JV to be soon approved,³⁰⁸ surprisingly accepting Gazprom's presence in the internal market too, which was precisely the most controversial point.³⁰⁹

Against this background, the meeting between Timoshenko and her Russian counterpart Viktor Zubkov did not achieve anything concrete: The Russian Prime Minister diplomatically referred to agreements reached earlier and insisted on the repayment of debts.³¹⁰ He reportedly tried to resurrect the proposal rejected already one year ago in Ukraine, of swapping downstream assets in Russia for shares in the transport system of Ukraine.³¹¹ In accordance with her policy, Timoshenko hailed the suppression of any intermediaries as already agreed, and perplexing as it may be, she broached plans similar to that of Zubkov, and which she so strenuously opposed one year before, namely, to establish a gas consortium in exchange for access in the Russian downstream sector.³¹² The Ukrainian Prime Minister also unrealistically proposed direct contracts with Central Asia,³¹³ running counter to the Russian side's firm strategy of establishing an unchallenged monopsony on Central Asian supplies.

The good harmony both sides showed in Moscow was obviously only apparent. Timoshenko's intention not to bend to Russian demands became manifest thereafter. Probably for mere propagandistic

³⁰⁶ Korets, Marina: "Iuliia Timoshenko postoiť za novoi' tsenoi' na gaz (юлия тимошенко постоит за новой ценой на газ)", *Trud*, 20 September 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries); Naumov, Igor' and Kulikov, Andrei': "Kiev trebuie peresmotra gazovykh dogovorenosti' (киев требует пересмотра газовых договоренностей)", *Nezavisimaia Gazeta*, 20 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

³⁰⁷ As known by the reader at this stage, these were prices for Central Asian gas, not Russian gas which was more expensive.

³⁰⁸ Zygari' and Grib, "Iz Iulii Timoshenko", *op. cit.*

³⁰⁹ This is somehow perplexing, as Turchinov himself seemed to have hinted at previous declarations, that in joint ventures, Naftohaz's role would be nominal and would hardly exert any influence (see: Kulikov, Sergei' and Naumov, Igor': "Timoshenko nadavila na gaz (тимошенко надала на газ)", *Nezavisimaia Gazeta*, 21 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

³¹⁰ Lavrov, Andrei': "ukroshchenie strotivnykh (укрошение стротивных)", *Gazeta*, 21 February 2008 (Accessed on the 22nd August 2011, from East View, Harvard Libraries); Grib, Natal'ia and Gavrish, Oleg: "'Gazprom' ne uslyshal Iuliiu Timoshenko ('Газпром' не услышал Юлию Тимошенко)", 22 February 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

³¹¹ Lavrov, "ukraschenie stroptivnykh", *op. cit.*

³¹² Grib and Gavrish, "'Gazprom' ne uslyshal Iuliiu Timoshenko ('Газпром' не услышал Юлию Тимошенко)", 22 February 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

³¹³ *Ibid.*

reasons,³¹⁴ as there was a manifest incoherence in her purposes, she stated that Gazprom had accepted to get rid immediately of intermediaries and establish direct supplies; she later had to clarify that direct supplies would automatically imply more expensive Russian gas instead of cheaper Central Asian gas.³¹⁵ She further clarified that such scheme would only be valid for the 1st quarter and that the condition of establishing new intermediaries for the next quarter was firm.³¹⁶ Timoshenko seemed to be lobbying for direct supplies for the transition period when UkrGazEnergo and RosUkrEnergo had been suppressed and before new JVs approved. Much of this looked like contrived arguments to force through her political agenda of eliminating RosUkrEnergo.

Gazprom now saw Yushchenko's agreements blocked by disagreements on its interpretation and nullified in practice by the government's insistence on reviewing them. Therefore, it warned that if Naftohaz did not pay the outstanding debt it would stop any supplies from Central Asian and sell expensive Russian gas instead.³¹⁷ Gazprom decided to ratchet up pressure against Naftohaz in the face of the latter's unwillingness to move forward with the 12th February agreement: if it had earlier hinted that supplies would be cut on 7th of April in case the deadline for a final agreement on new intermediaries was not respected (1st of April),³¹⁸ the deadline was now moved back to 3rd of March, 10:00 am. If not met and debt remained unpaid, supplies would be cut by 25%.³¹⁹

Gazprom had thus made clear that repaying the debt was the most urgent matter. Naftohaz had reportedly made a new payment and claimed the whole debt to be repaid. Gazprom disagreed and stated that only US\$280mill had been transferred so far (while nearly US\$1bill had accumulated from November and December 2007).³²⁰ In addition to this,³²¹ the complete refusal to abide by the 12th February

³¹⁴ Much debated at the time was the competition between Timoshenko and Yushchenko and the need for both to score points in such a contentious issue as gas supply for Ukraine was, in preparation for the presidential elections of late 2009, where the two politicians would (and eventually did) compete against each other. It is otherwise hardly understandable why Timoshenko would have gone as far as to propose an international consortium for transportation which had been a taboo so far, only supported by politicians from the Party of Regions (mainly Boi'ko and in opposition to other members of the same party) and bitterly fought by herself when similar proposals were made in early 2007 (see above).

³¹⁵ Grivach, Alexei': "Zhazhda obshcheniia (Жажда общения)", *Vremia Novostei*', 22 February 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

³¹⁶ *Ibid.*

³¹⁷ Grib, Natal'ia: "Ukraina rasplatilas' s Rossiei' (Украина расплатилась с Россией)", *Kommersant*, 28 February 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³¹⁸ Zygari' and Grib, "Iz Iulii Timoshenko", *op. cit.*

³¹⁹ Lavrov, Andrei': "Gazprom obeshchaet perekrit' Ukraine ventil' (газпром обещает перекрыть украине вентиль)", *Gazeta*, 27 February 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

³²⁰ Grib, Natal'ia and Gavrish, Oleg: "Iuliia Timoshenko ne khochet platit' za Viktora Iushchenko (Юлия Тимошенко не хочет платить за Виктора Ющенко)", *Kommersant*, 27 February 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

³²¹ Grivach, Alexei': "Ukrainskaia bolezni' koalitsii (Украинская болезнь коалиции)", *Vremia Novostei*', 28 February 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

agreement and the constitution of a substitute for UkrGazEnergo,³²² made the situation explosive. This verbal escalation was followed by new payments made to UkrGazEnergo, who received an additional amount of US\$337mill³²³ or US\$484mill³²⁴ according to the sources. However a minor sum of US\$271mill still remained to be paid. For this latest payment Naftohaz shunned responsibility and pretended to charge it exclusively on UkrGazEnergo for allegedly unpaid dividends for 2006-07.³²⁵ This new argument was plainly rejected by RosUkrEnergo.³²⁶ Timoshenko showed no flexibility on the issue of intermediaries and unilaterally decided that no intermediary would be allowed to work in the Ukrainian market after 1st of March,³²⁷ issuing orders to put a legal end to UkrGazEnergo in the internal market.³²⁸ Given the circumstances, Gazprom was left with no other alternative than to escalate and carry out its recent threats.

7. 5. The Gas Dispute and Eventual Agreements

After a latest round of negotiations had failed,³²⁹ Gazprom, as already warned some days before, reduced on 3rd March 2008 the flow of gas corresponding to Ukrainian consumption by 25%.³³⁰ Naftohaz's Head of the public relations department, Valentin Zemliansky, stated the company could easily make up for the reduction through its own reserves.³³¹ As he declared, reserves were sufficient for a whole month in case the gas cut-offs continued.³³²

³²² Grib and Gavrish, "Iuliia Timoshenko ne khochet", *op. cit.*

³²³ Mazneva, Elena: "Novyi' ul'timatium (Новый ультиматум)", *Vedomosti*, 27 February 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³²⁴ Grib, "Ukraina rasplatilas'", *op. cit.*

³²⁵ *Ibid.*

³²⁶ Beliakov, Evgenii': "Trudnosti ucheta (трудности учета)", *Gazeta*, 29 February 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries). The argument was that a decision on dividends for 2006 had not been taken yet, and it was thus also premature to start talking about dividends for 2007.

³²⁷ "Naftogas Ukrainy ready to buy Central Asian gas from Gazpromexport –PM", *Itar-Tass*, 1 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³²⁸ Bazak, Oleg: "Udar po pochkam (удар по почкам)", *Moskovskii' Komsomolets*, 1 March 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³²⁹ Grivach, Alexei': "'Ni edinoi' kapli gaza" ("Ни единой капли газа")", *Vremia Novostei'*, 3 March 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

³³⁰ "Gazprom cuts gas supplies to Ukraine by 25 prc", *Itar-Tass*, 3 March 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

³³¹ "Gazprom cuts gas supplies", *op. cit.*

³³² "Naftogaz Ukrainy has enough gas for 1 month of continuous work", *Itar-Tass*, 3 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries). He recalculated and then updated the expected period for maintaining normal supplies to only 2 weeks after Gazprom further reduced supplies (see: "Ukraine to keep normal gas supply 2 weeks after new restriction", *Itar-Tass*, 4 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

The next day, with solutions out of sight, Gazprom decided to cut supplies by another 25%. Ukraine was thus left with only 50% of its normal supplies.³³³ If the situation persisted, Gazprom warned that further reductions would ensue.³³⁴ However, far from backtracking, the Ukrainian side seemed ready for a similar strategy as that of January 2006, namely to siphon off gas in transit to Central and Western Europe and thus further escalate this new dispute. As Sergei Kuprianov declared, Naftohaz had published a press release informing that such step would be taken if Gazprom did not restore normal supplies.³³⁵ The wording of the press release made intentions quite clear: *"If Gazprom continues to crudely violate technical agreements between the two countries and reduce the delivery of Central Asian gas to Ukraine, Naftohaz Ukrainy reserves the right to take proportionate and asymmetric action to protect the interests of Ukrainian consumers"*.³³⁶

Naftohaz nuanced this warning when it asserted that such a measure would be taken only in the event of Ukraine's energy security being endangered,³³⁷ but Gazprom quite probably understood that there was a real danger. The fact that Naftohaz did not allow experts from SGS, the Swiss-based consulting company that had been contracted to monitor the flow of gas from Ukrainian pumping stations, raised suspicions that Ukraine was ready to carry out unsanctioned off-takes.³³⁸ Gazprom even claimed that Ukraine had already illegally extracted 104mcm of Russian gas³³⁹ and Naftohaz at some point seems to have warned that 60mcm of gas would go missing for Europe on the 5th of March.³⁴⁰ Gazprom's claim was never confirmed and no restriction was ever reported from Europe,³⁴¹ whereas

³³³ "Gazprom cuts gas supply to Ukraine by 1/4 to 50% over debt", *Itar-Tass*, 4 March 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

³³⁴ "Gazprom does not rule out new reduction of gas supply to Ukraine", *Itar-Tass*, 4 March 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

³³⁵ "Naftogaz ready to siphon off gas if supply is cut further – official", *Itar-Tass*, 4 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³³⁶ "Ukraine guarantees gas transit if security not in jeopardy", *Itar-Tass*, 4 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³³⁷ *Ibid.*; the concept of energy security in this case was ambiguous. After Mr. Zemlianskii reduced from one month to two weeks the calculated period for maintaining normal supplies for consumers, it seems easy to draw the conclusion that the stage of energy insecurity would be possibly reached when cuts reached 100%. This would thus link unsanctioned use of Russian gas to the same stage at which Gazprom had started the dispute in 2006 and to which Ukraine responded in the same way as it was now warning it would.

³³⁸ Pavlovich, Dmitrii: "Davlenie gazom (давление газом)", *Gazeta*, 5 March 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³³⁹ Beliakov, Evgenii: "Doi'ti do Stockgolma (дойти до стокголма)", *Gazeta*, 5 March 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

³⁴⁰ "Gazprom resumes gas supplies to Ukraine in full – spokesman", *Itar-Tass*, 5 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries); "Naftogaz warns it may reduce gas transit to Europe", *Itar-Tass*, 5 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³⁴¹ In the last day of the dispute Hungarian Emfesz did not report any problem in gas supplies (Mazneva, Elena: "Gaz bez sprosa (Газ без спроса)", *Vedomosti*, 5 March 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries) and soon it became clear that no interruptions whatsoever had occurred in Europe (Pavlovich, Dmitrii: "Gaz poshel (газ пошел)", *Gazeta*, 6 March 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries)).

Naftohaz's announcement was denied by both the Ukrainian President and his Prime Minister.³⁴² These were false warnings, but disruptions of Russian gas appeared very likely with some experts claiming that Naftohaz had not stored gas enough for coping with eventual restrictions.³⁴³

Gazprom decides to deescalate the dispute and restores supply while negotiations continue

Then, Gazprom decided to deescalate the gas dispute, restoring supplies and going back to conversations with Naftohaz to solve all outstanding points. An apparent reason for this sudden decision was that Naftohaz and Gazprom had agreed to pay for the Russian gas delivered since January 1st.³⁴⁴ However, this looked more like a generic statement. A date was fixed on 11th March to celebrate a bilateral meeting,³⁴⁵ while Mikhail Korchemkin, asked by *The Moscow Times*, suggested that Gazprom had agreed to backtrack and eventually accept that all gas supplied for January-February would be priced at 179.5bcm.³⁴⁶

If to believe the Ukrainian Prime Minister herself, her position had not moved substantially in spite of the dispute. She made clear she would not fulfill the President's February agreement and insisted on direct supplies without intermediaries.³⁴⁷ She actually went as far as to send a decree to the President announcing the government's decision to cancel the agreement.³⁴⁸ The main point of contention was, as in the days before the dispute, the substitution of UkrGazEnergo. Timoshenko suggested ways to compensate Gazprom in a new agreement, which raised at that moment some doubts: one interpretation was that 25% of the Ukrainian import gas market would be open for Gazprom (the equivalent of its share in UkrGazEnergo), while another was that Gazprom could only sell as much as 5bcm. The latter volume was coincidentally the same as Timoshenko's proposed restriction for UkrGazEnergo, defended earlier in 2006. Still another interpretation was that Timoshenko proposed Gazprom a scarce 25% of these 5bcm,

³⁴² "Gazprom resumes gas supplies", *op. cit.*

³⁴³ Grishin, Aleksandr: "obmen udarami (обмен ударами)", *Moskovskii' Komsomolets*, 5 March 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries); Ivzhenko, Tat'iana: "Gazovoia voi'na s ukrainoi' nakroet evropu (газовая война с Украиной накроет Европу)", *Nezavisimaia Gazeta*, 5 March 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

³⁴⁴ "Joint Statement of OAO Gazprom and NAK Naftogaz Ukrainy", *Gazprom News*, 5 March 2008, at <http://www.gazprom.com/press/news/2008/march/article64102/> (Accessed on the 15th February 2013).

³⁴⁵ "Naftogaz Ukrainy, Gazprom to resume March 11", *Itar-Tass*, 5 March 2008 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

³⁴⁶ See: Smolchenko, Anna: "Gazprom restores gas to Ukraine", *The Moscow Times*, 6 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³⁴⁷ Pavlovich, Dmitrii': "Gazprom ostavili bez posrednikov (газпром оставили без посредников)", *Gazeta*, 7 March 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

³⁴⁸ Kulikov, Sergei': "Timoshenko b'it po prezidentam (тимошенко б'ит по президентам)", *Nezavisimaia Gazeta*, 7 March 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

which yielded a meager 1.25bcm.³⁴⁹ At the same time, the Head of the National Regulatory Commission for Energy proposed to offer Gazprom as much as 26bcm, which he identified as the equivalent of 35% of the Ukrainian (presumably, whole) gas market.³⁵⁰

President Yushchenko also intervened in this new phase, supporting his Prime Minister. While disavowing Timoshenko's recent statements, probably just for political reasons, he nevertheless expressed doubts as to the convenience of the agreement he had himself approved in February. Yushchenko now said the agreement considered imports of more expensive Russian gas, which in fact was incorrect, as Russian gas only referred to volumes exceptionally purchased to cover undersupply from Central Asia. He also claimed that no deal had been closed to establish JVs, something which again was not true. Yushchenko's effort to backtrack was probably related to the agreement's unpopularity. Since Timoshenko went on the offensive to revise it and "survived" the short gas cut-offs,³⁵¹ the President seemed to have no other alternative but to side with his political foe. He thus issued a directive for the new upcoming round of negotiations, where he supported a scheme of direct relations between Gazprom and Naftohaz, even if he still acknowledged that a JV between the two state companies might be necessary.³⁵²

An agreement is reached between Ukraine and Russia

The controversy of Russian natural gas

As already announced, Naftohaz's delegation went to Moscow on 11th March. First among the items in discussion, was the controversy surrounding Russian gas. The Ukrainian side agreed to pay for its real price, that is, US\$321bcm. It was revealed at that moment that in fact, this might have been agreed in secret as early as on 6th March in trilateral negotiations between Naftohaz, Gazprom and RosUkrEnergo.³⁵³ Once this had been agreed, the exact amount of Russian gas sold in January and

³⁴⁹ Mazneva, Elena: "Gazovyi' krizis prodolzhaetsia (Газовый кризис продолжается)", *Vedomosti*, 7 March 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries); Mordiusenko, Ol'ga: "Iuliia Timoshenko priglashaet "Gazprom" na Ukrainu (Юлия Тимошенко приглашает "Газпром" на Украину)", *Kommersant*, 7 March 2008 (Accessed on the 22nd August 2011, from East View, Harvard Libraries); Kulikov, "Timoshenko b'it po prezidentam", *op. cit.*

³⁵⁰ Mordiusenko, "Iuliia Timoshenko priglashaet "Gazprom"", *op. cit.*

³⁵¹ "Ukraine's president, PM at odds about gas accords with Russia", *Itar-Tass*, 7 March 2007 (Accessed on the 31st August 2011, from East View, Harvard Libraries). In essence, the President published the agreement signed in February where it appeared that the second JV would be created "in case of need", which indeed was less categorical than what was earlier said. The timing however for this clarification was meant to counter Timoshenko's public denial of the agreement (see: Grivach, "Sovershenno nesekretno", *op cit.*).

³⁵² "Russia - Ukraine gas talks resume in Moscow", *Itar-Tass*, 12 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³⁵³ Gavrish, Oleg; Golubeva, Alena and Grib, Natal'ia: "Ukraina priznala gaz rossiiskim (Украина признала газ российским)", *Kommersant*, 11 March 2008 (Accessed on the 22th August 2011, from East View, Harvard Libraries).

February had to be determined. Sources from Gazprom talked of a minimum of 4bcm,³⁵⁴ while others wrongly reported that all the gas provided in January-February was exclusively Russian.³⁵⁵ Press reports thereafter reduced volumes to 1.9bcm,³⁵⁶ and the total volume was finally confirmed to be only 1.4bcm. But the most important element in this long-drawn-out disagreement was the modality of payment agreed: gas would be paid for not in cash, but through barter instead.³⁵⁷ This solved the controversy whether Gazprom wanted to abuse Naftohaz by selling more expensive Russian gas and that had caused an uproar in Ukraine. If gas was simply swapped, as soon as Ukraine received from Central Asian the volumes of gas it should have received back in January and February, Naftohaz could then easily return the volumes in dispute to Gazprom.³⁵⁸ The pricing issue that had been at the very center of the controversy, appeared to be irrelevant.

The suppression of UkrGazEnergo and the appearance of "Gazprom Sbyt Ukraina"

The other big item, the re-organization of gas import market in Ukraine, was also the object of an agreement, modifying what had been agreed back in February by the two presidents: UkrGazEnergo, for which Naftohaz and Gazprom had planned in February a new JV, would be simply eliminated. Naftohaz would thus regain complete control of imported gas in the internal market.³⁵⁹ Gazprom would be compensated for losing its share of UkrGazEnergo: it gained the right for direct sales of up to 10% of the Ukrainian gas market through a new filial, "Gazprom Sbyt Ukraina";³⁶⁰ Gazprom could thus sell as much as 7.5bcm.³⁶¹ According to a press release from Gazprom: *"From April 1, 2008, a Gazprom subsidiary or affiliated company will annually effectuate direct gas deliveries to Ukrainian industrial consumers in the volume of no less than 7.5 b.c.m."*³⁶² As the reader may be used to seeing, a great deal of confusion remained as to the exact meaning of this agreement.

³⁵⁴ *Ibid.*

³⁵⁵ "Gazprom to make public results of talks with Ukraine Naftogaz", *Itar-Tass*, 13 March 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

³⁵⁶ Grivach, Alexei': "I nashim i vashim (И нашим и вашим)", *Vremia Novostei*, 14 March 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

³⁵⁷ "URGENT - Ukraine to return 1,4 bln c m of gas to Gazprom", *Itar-Tass*, 14 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³⁵⁸ Vas'kovskaia, Iana: "Kubometrov gaza poderzhali Timoshenko (кубометры газа поддержали Тимошенко)", *Novaia Gazeta*, 17 March 2008 (Accessed on the 23th August 2011, from East View, Harvard Libraries).

³⁵⁹ "Kiev to pay 180 dlr for gas 2008, Gazprom has 10 pct of Ukraine mkt", *Itar-Tass*, 13 March 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

³⁶⁰ *Ibid.*

³⁶¹ *Ibid.*

³⁶² "Gazprom and Naftogaz Ukrainy enter into Agreement to develop relations in gas sector", *Gazprom News*, 13 March 2008, at <http://www.gazprom.com/press/news/2008/march/article64098/> (Accessed on the 19th February 2013).

Some, initially, suspected that what this solution foresaw was the creation of an emergency mechanism to avoid any disputes whenever Ukraine temporarily needed Russian gas to cover demand, as had happened recently. Leonid Grigoriev (at the time president of the Energy and Finance Institute, Russia) explained that Gazprom would be allowed to sell a maximum of 7.5bcm in case Russian gas was exceptionally needed.³⁶³ If true, this arrangement was nothing more than a face-saving device for Gazprom. Whatever real utility this arrangement might eventually have as a real insurance against non-payments, it did not secure for Gazprom a permanent presence in the Ukrainian energy market. The reason for suspecting this was that enough gas had been already contracted from Central Asia (49.8bcm for the rest of the year) at more advantageous prices of US\$179.5tcm.³⁶⁴ It was easy to conclude that "Gazprom Sbyt Ukraina" would only sell gas in the Ukrainian market in cases of emergency.³⁶⁵ Kuprianov's declarations, as relayed by the press, where he just talked of a mere "possibility" when referring to the new volumes agreed for Gazprom's filial,³⁶⁶ and the fact that the reference was to a maximum volume, arguably supported this interpretation.

However, it was later acknowledged that the agreement did provide for 7.5bcm to be sold to "Gazprom Sbyt Ukraina" directly by Naftohaz on a permanent basis. It seemed that contrary to the initial interpretation, "Gazprom Sbyt Ukraina" would not sell Russian gas to Naftohaz. Instead, "Gazprom Sbyt Ukraina" would simply become a trader in the internal market of Ukraine, with a right to purchase 7.5bcm of gas from Naftohaz (imported from RosUkrEnergo), to be sold to consumers in the industrial sector. The trader would thus obtain its profits from selling to end-consumers in Ukraine. In spite of this, when discussions started on how to apply this provision, disagreements and reinterpretations generated new controversy.

³⁶³ "Gazprom's access to 10 pct of Ukraine's mkt to prevent conflicts", *Itar-Tass*, 13 March 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³⁶⁴ Grib, Natal'ia; Gavrish, Oleg and Konstantinov, Aleksandr: "Iuliia Timoshenko nabila sebe tsenu (Юлия Тимошенко набила себе цену)", *Kommersant*, 14 March 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

³⁶⁵ Controversies soon surfaced regarding this point: Timoshenko claimed the right only concerned 2008 (see: Grivach, Alexei: "Primirenie v aeroportu (Примирение в аэропорту)", *Vremia Novostei*, 17 March 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries), something which would just nullify this provision, as no Russian gas was needed. The Russian Minister of Energy himself, Viktor Khristenko, clarified that the recently signed agreement only concerned 2008 (see: "Russia, Gazprom interested in long - term, reliable stable relations with Ukraine", *Itar-Tass*, 19 March 2008 (Accessed on the 30st August 2011, from East View, Harvard Libraries), although the agreement talked of a long-term agreement (see: Grivach, Alexei: "Ukraina snova v boi' (Украина снова в бой)", *Vremia Novostei*, 20 March 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries). It seemed the government was modifying unilaterally provisions of the agreement by the time it officially endorsed it, fixing 2008 as the only year for validity of Gazprom's access (see *Ibid.*).

³⁶⁶ Gel'tishev, Petr and Korets, Marina: "Ukraina izbavilas' ot posrednikov (украина избавилась от посредников)", *Trud*, 14 March 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

The Ukrainian government took the unilateral step of restricting the license for Gazprom's controversial filial: "Gazprom Sbyt Ukraina" could only operate during the current year and it was confirmed that 7.5bcm was the maximum and not the minimum, as some suspected.³⁶⁷ However, when negotiations between Gazprom and Naftohaz in early April led to "Gazprom Sbyt Ukraina" being granted a license, Gazprom agreed on the maximum volume while Naftohaz granted the licence not for one, but for five years.³⁶⁸ "Gazprom Sbyt Ukraina" would start servicing from May 1st. The concession of a license for five years was interpreted by some as an attempt to influence Gazprom in ongoing pricing negotiations.³⁶⁹ Rumors even pointed to President Yushchenko as the initiator of such concession in the face of the Prime Minister's opposition.³⁷⁰

The margin of profits that *Vremia Novosti* calculated for the new company ranged from US\$6tcm to US\$7tcm. That would translate into US\$40mill-US\$50mill for the rest of the year.³⁷¹ Elena Mazneva from *Vedomosti* calculated a similar profit margin : "Gazprom Sbyt Ukraina" could gain as much as US\$41mill-US\$61mill per year.³⁷² This calculation assumed the trader would sell as much as 7.5bcm. However, as it had been agreed, this was only a maximum. And indeed, that maximum would not be reached: as it was revealed some months later, the trader only sold 3bcm of gas in 2008.³⁷³ It is therefore safe to assume that the figure of 7.5bcm per year might have served Gazprom to save face.

The status quo regarding RosUkrEnergo

Regarding RosUkrEnergo, the new agreement remained secret. If the February agreement did not foresee its disappearance before 2009, the March agreement did not modify anything. In fact, nothing was said of its fate beyond 2008 either.³⁷⁴ Iurii Boi'ko, former Minister of Energy (linked to RosUkrEnergo through

³⁶⁷ "U Ukrainy otleglo ot truby (У Украины отлегло от трубы)", *Kommersant*, 15 March 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries). Besides that, it was also agreed that Naftohaz would pay the remaining US\$190mill still owned from 2007.

³⁶⁸ Grib, Natal'ia: ""Gazprom" propisyvaetsia na Ukraine ("Газпром" прописывается на Украине), *Kommersant*, 9 April 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³⁶⁹ Grivach, Alexei': "Piatiletka po-kievski (Пятилетка по-киевски)", *Vremia Novosti*, 25 April 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³⁷⁰ Ivzhenko, Tat'iana: "Piatiletka l'gotnikh tsen (ПЯТИЛЕТКА ЛЬГОТНЫХ ЦЕН)", *Nezavisimaia Gazeta*, 12 May 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

³⁷¹ Grivach, "Piatiletka po-kievski", *op. cit.*

³⁷² Mazneva, Elena: "Vtoraia popytka (Вторая попытка)", *Vedomosti*, 25 April 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³⁷³ Mostovaia, Iuliia: "Kompromiss. I zhizn posle nego (Компромисс. И жизнь после него)", *Zerkalo Nedeli*, 24-30 January 2009, at http://gazeta.zn.ua/POLITICS/kompromiss_i_zhizn_posle_nego.html (Accessed on the 24th of October 2013) Gazprom Sbyt would eventually sell only 1.85 bcm in 2009 and 3.24 bcm in 2010 (see: IEA (2012): "Ukraine: Energy Policy Review", p. 116 at

http://www.iea.org/publications/freepublications/publication/Ukraine2012_free.pdf (Accessed on the 10th February 2014).

³⁷⁴ Kashin, Vasilii': "Rosukrenergo budet zhit' (Rosukrenergo будет жить)", *Vedomosti*, 14 March 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

his close relations to Dmitro Firtash), simply confirmed that the trader would operate until the end of the year.³⁷⁵ It seems that in this respect, both parts preferred to maintain the status quo and leave the matter to rest until negotiations for gas prices in 2009 started. Timoshenko could boast a clear victory over UkrGazEnergo, but she had not forgotten RosUkrEnergo, which could still become the target of unilateral modifications suddenly announced by the Ukrainian government:

The Prime Minister decided that RosUkrEnergo's services would be valid only for the period of January-March,³⁷⁶ besides prohibiting the trader from exporting gas to Europe through Ukrainian territory and thus depriving RosUkrEnergo of its biggest share of profits.³⁷⁷ *Nezavisimaia Gazeta* suspected that Naftohaz might try to immediately assume RosUkrEnergo's commitments to European customers, which could be made by way of forcing the trader to repurchase gas from Naftohaz at the Ukrainian-Polish border.³⁷⁸ Negotiations regarding the status of RosUkrEnergo continued well into April, but soon the Ukrainian side gave up on its attempts to get rid of RosUkrEnergo before the end of 2008. Naftohaz had to accept the presence of the intermediary and refrained from unilateral moves.³⁷⁹ This final "victory" by RosUkrEnergo initially raised doubts whether Naftohaz's leadership had decided to disobey the Prime Minister,³⁸⁰ but it soon appeared that the Prime Minister herself, who tightly held control of energy issues, had conceded in that point.³⁸¹

Interpretations of the new agreement

Most assessments tended to characterize Gazprom as the loser in this latest dispute. *Kommersant* bluntly explained de-escalation as a response to the threat of supply disruptions to European customers, considering that Gazprom resumed supplies to Ukraine without any concession from Naftohaz.³⁸² Experts consulted by *Nezavisimaia Gazeta* also agreed with that assessment and thought Gazprom backtracked as

³⁷⁵ "RosUkrEnergo remains gas supplier to Ukraine by yearend", *Itar-Tass*, 14 March 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³⁷⁶ Grib, Natal'ia: "Ukraina perepisala soglasenie s "Gazpromom" (Украина переписала соглашение с "Газпромом")", *Kommersant*, 20 March 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

³⁷⁷ Grib, Natal'ia and Gavrish, Oleg: "Ukraina perekryla Rosukrenergo dostup v ES (Украина перекрыла Rosukrenergo доступ в ЕС)", *Kommersant*, 21 March 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³⁷⁸ Trempel', "Posredniku zakryli kran", *op. cit.*; probably forcing RosUkrEnergo to forego any benefits, as Naftohaz would surely sell back the gas at market prices.

³⁷⁹ Grib, Natal'ia: "Rosukrenergo ostalas' v skheme "Gazproma" (Rosukrenergo осталась в схеме "Газпрома")", *Kommersant*, 12 April 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³⁸⁰ Grivach, Alexei': "Nelegitimnyi' gaz (Нелегитимный газ)", *Vremia Novostei*, 14 April 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³⁸¹ Ivzhenko, "Otnosheniia Moskvu", *op. cit.*

³⁸² Mordiusenko, Olga and Gavrish, Oleg: "Gazprom" sdalsia Ukraine ("Газпром" сдался Украине)", *Kommersant*, 6 March 2008, at <http://www.kommersant.ru/doc/864052> (Accessed on the 15th February 2014). Sources from Gazprom considered that the only concession from the side of Naftohaz was their agreement to secure outstanding payments through the intermediaries and thus postpone their immediate demise.

it feared to lose reputation among European customers.³⁸³ The newspaper found new proof of Ukraine's feeling of victory in the fact that Timoshenko's negotiating position after the resumption of supplies did not move and tried on the contrary to exploit Russia's apparent weakness.³⁸⁴ Another assessment by *Novaia Gazeta* also considered Timoshenko as the winner, in contrast to what they considered the Ukrainian defeat of January 2006. This assessment highlighted the fact that in spite of much talk of Timoshenko's concession to pay "European prices" for Russian gas, Ukraine successfully managed to pay by barter instead.³⁸⁵ *Moskovskaia Pravda* also thought that Ukraine had won the dispute, even if the victory had been pyrrhic, as it considered that Ukrainian assessments of prospective gas consumption in Ukraine for 2008 were wrong, so Central Asian gas would not suffice and some expensive Russian gas would have to be purchased.³⁸⁶ *Izvestiia* on the contrary, rang a rather positive tone of the agreement, understandably given Gazprom's indirect ownership. It assessed that "*through minor concessions, (Gazprom) had gained guarantees for debt clearance and a more transparent framework of relations*",³⁸⁷ highlighting the share of 10% of Ukraine's internal gas market that Gazprom had gained through its new subsidiary.³⁸⁸

7. 6. Preliminary Conclusions

This episode may appear indeed, as Gazprom's defeat. It must nevertheless be pointed out that the stakes were not as high as in January 2006 or as they soon would be in January 2009. As opposed to the two "big" disputes (see previous and next chapter), this dispute happened because of a debt problem, not a major issue as pricing agreements are. It must also be borne in mind when assessing this latest dispute, that Gazprom received a guarantee for repayment and thus averted losses. Nevertheless, a puzzle is why Russia escalated this debt dispute and cut off gas instead of pursuing negotiations as with other debt disputes in the past. Most probably this was linked to the perspective of a new government headed by Timoshenko. In fact, this had happened already the year before.

³⁸³ Kulikov, Sergei: "Gazprom pripugnuli evropoi' ("газпром припугнули европой)", *Nezavisimaia Gazeta*, 6 March 2008 (Accessed on 17th August 2011, from East View, Harvard Libraries).

³⁸⁴ Pavlovich: "Gazprom ostavili", *op cit.*

³⁸⁵ Vas'kovskaia, "'Kubometrov gaza", *op. cit.*

³⁸⁶ Krelasvskii, Vladimir: "Kto vyigral ot gazovogo konflikta (кто выиграл от газового конфликта)", *Moskovskaia Pravda*, 15 March 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

³⁸⁷ Chai'ka, Fedor: "Velikoe peremirie sosedei' (Великое перемирие соседей)", *Izvestiia*, 14 March 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

³⁸⁸ *Ibid.*

When the debt dispute of October-November 2007 took place (as analyzed above), Gazprom had already threatened to stop supplies if debt was not repaid. This happened after an "orange" majority had been voted in the parliamentary elections of 30th September, but while Yanukovich was still Prime Minister. The threat to cut off gas supplies for a simple debt issue was made for the first time. The coincidence with new political changes raised the suspicion that the expected election of Yulia Timoshenko as Prime Minister (she was elected by the new parliament on the 18th of December 2007) had something to do with this surprising hardening of Russian positions. As Gazprom did not escalate verbally when Timoshenko reached the post of Prime Minister, but while Yanukovich was head of the government and as tension defused when an agreement was reached, it does not point to a political use of the debt issue. It rather points to a preventive move by Gazprom to solve the problem before the new government was formed. As Timoshenko promised to enforce radical changes in the energy market, Gazprom's move seems logical.

The sequence of events when debt issues resurfaced in February 2008 seems to follow the same logic. On this occasion, Gazprom stepped up and threatened more clearly to reduce supplies. Timoshenko was now head of the new government and tried thus to push forward with her plans of eliminating any intermediaries. Her government denied any responsibility and blamed RosUkrEnergo and UkrGazEnergo for the debt, even if Ukraine was at the origin of this new episode of indebtedness. Gazprom could perceive that the debt dispute was being used as an argument to blame intermediaries and thus push for the government's unilateral policy of establishing direct supplies in Russia-Ukrainian energy relations. The dispute reached its apex when Timoshenko attempted to nullify the 12^{ve} February agreement and threats translated into action: Gazprom imposed two days of partial cuts, 25% of normal supplies to Ukraine the first day and 50% the next day. Gazprom might have started the dispute, either because Timoshenko's policy worsened Gazprom's position or because improvements in the 12^{ve} February agreement raised the stakes involved. However, the relevant fact is that Gazprom had already set a clear deadline for gas cut-offs and only modified it to give more room to negotiations with Yushchenko. It is a credible assumption that gas cut-offs were already planned not as a simple threat, but as a real warning too.

The reasons for Gazprom not to further escalate the dispute into a total cut-off could be answered in two different ways:

Either Gazprom fulfilled its target, with losses averted or gains achieved, or deescalated the dispute as risks of losses it did not want to assume were too high. Most analyses, as seen above, tended to

respond negatively to the first interpretation. It is reasonable to think so: when Gazprom decided to de-escalate, no agreement had been reached beyond generic promises from the Ukrainian side to go back to negotiations. This will be further assessed in chapter 9, where the result of the three disputes will be fully analyzed.

The second answer, namely that Gazprom behaved as a risk-averting actor, seems more promising and opens the door to a prospect theory-based analysis. Gazprom deescalated the dispute when the Ukrainian side hinted at gas disruptions. As Gazprom arguably did not want to risk its reputation as in January 2006, it made sense to revert to negotiations. The agreement which was eventually reached in the next did not represent a victory for Gazprom: Gazprom had its debt repaid and reached its main objectives, arguably averting losses. However, the new agreement represented an important concession regarding gains achieved in the 12^{ve} February agreement, as Gazprom's share in Ukraine's internal market was reduced to a mere testimonial presence. Russia apparently preferred to forsake some gains made in the first agreement, in exchange for averting the potential loss of reverting to the risk of gas disruptions. As stated in our previous chapters, conclusions in chapter 11 will expand a prospect-theory based interpretation , determining at the same time the balance between economic and political factors.

Chapter 8: Russia-Ukraine Energy Dispute of January 2009

8. 1. Introduction: Again, Pricing Changes from Central Asia

While Russia and Ukraine were in the midst of a debt dispute which escalated into the short gas cut-off of March 2008, new tremors were coming from Central Asia. We must not forget that Central Asia had been the main source for most pricing changes to date. It had strongly contributed to tensions in recent years between Russia and Ukraine (See chapter 6) and since 2006, only Central Asian gas was consumed by Ukraine. Therefore, prices for 2007 and 2008 had depended on price changes from these regions (mainly Turkmenistan) (See chapter 7) and new prices for 2009 would necessarily be raised again if the same trend continued. It may be argued that this would have a sizable influence on the energy dispute of January 2009, which was to last as much as three weeks and lead to a severe supply crisis in most dependent countries of Central Europe.

In March 2008, the three Central Asian republics of Turkmenistan, Kazakhstan and Uzbekistan that had been supplying gas to Ukraine, made a joint declaration demanding that from 2009 market prices be established for exported gas. Under the term "market prices", it was understood that the objective was to determine gas pricing following international oil prices. This was essentially the same system Gazprom used for its European customers (and wanted to impose on Ukraine too) and was very similar to what Kazakhstan had been using from 2008.¹ If applied, this would immediately translate into higher prices for Ukraine.

According to *Vedomosti*'s estimate, prospective prices of Central Asian gas would range between US\$270-US\$300tcm at the their respective borders (that is at Turkmen, Uzbek and Kazakh borders):² if Turkmenistan chose prices ranging from US\$250tcm to US\$270tcm and Kazakhstan and Uzbekistan pushed for US\$200-US\$220tcm,³ the final price for Ukraine might result in something around US\$320tcm. This was in fact close to what Gazprom charged for its gas exports.⁴ Other analysts calculated different prices: *Deutsche Bank* estimated the likely price for Ukraine would exceed US\$250

¹ Mazneva, Elena: "Aziia trebuets doplatit' (Азия требует доплатить)", *Vedomosti*, 12 March 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

² *Ibid.*

³ Grivach, Alexei: "Put' k evropei'skoi' tsene (Путь к европейской цене)", *Vremia Novostei*, 13 March 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

⁴ Grib, Natal'ia; Gavrish, Oleg and Konstantinov, Aleksandr: "Natsenka po povedeniiu (Наценка по поведению)", *Kommersant*, 12 March 2008 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

and analysts from *MDM Bank* calculated a range from US\$275tcm to US\$320tcm.⁵ Former Prime Minister of Energy Iurii´ Boi´ko was particularly pessimistic: he predicted, as the best of prospects, a price for Ukraine at US\$370tcm.⁶

Whatever the exact price, it was certain that Ukraine would henceforth lose advantageous prices it had been enjoying. The only hope for Ukraine was that Gazprom exerted as much pressure as possible on the three Central Asian gas producers in order to prevent such price increases. However, Gazprom did not in fact have much margin for negotiating. As the analyst Mikhail Zanozin from *Zobinbank* explained, in the face of European and Chinese competition for Central Asian resources, accepting more expensive prices was in fact the best guarantee for Gazprom to nip in the bud attempts at lowering Russian monopsony in favor of competing consumers like China.⁷

There was therefore a clear dilemma for Gazprom and only two options: either Ukraine accepted higher prices to absorb price increases, or Russia ended up assuming the price differential and subsidizing the Ukrainian energy market. Only the first option looked realistic and corresponded to what Ukraine had done successively in 2006, 2007 and 2008, namely, to reflect price hikes from Central Asia. It was therefore most unlikely that Gazprom would now accept an exception hurting both its financial position and its policy of market transition for gas prices. As an importer of exclusively Central Asian gas, Ukraine was a full target of these changes.⁸ Thus, the recent announcement from Central Asia forebode new troublesome negotiations between Gazprom and Naftohaz, as the latter would not readily accept new and higher prices.

The danger was that if Ukraine did not accept new price increases, both Russia and Ukraine entered a conflict spiral with each of them using their "weapons". As we had the occasion to see earlier, Ukraine could use transit tariffs and fees for storage facilities, either to nullify price increases or in order to use them to apply pressure in negotiations. Valentin Zemlianskii´, Naftohaz´s press secretary, mentioned this in direct relation with the expected price increases from Central Asia.⁹ But with Gazprom making it clear that Ukraine should be prepared for adapting to new prices,¹⁰ Ukraine´s best strategy was

⁵ Medetskii´, Anatolii´: "Moscow promises tough gas talks", *Itar-Tass*, 17 March 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

⁶ Trempeľ, Alexandr: "Aziatskaia torgovlia po evropei´ske tse nam (АЗИАТСКАЯ ТОРГОВЛЯ ПО ЕВРОПЕЙСКИМ ЦЕНАМ)", *Gazeta*, 28 April 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

⁷ Kulikov, Sergei´: "Gazprom" gotov poi´ti navstrechu Kievu ("ГАЗПРОМ" ГОТОВ ПОЙТИ НАВСТРЕЧУ КИЕВУ)", *Nezavisimaia Gazeta*, 22 May 2008 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

⁸ "Ukraine to suffer most from higher price of Central Asian gas – view", *Itar-Tass*, 12 March 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

⁹ Grivach, "Put´ k evropei´skei´ tsene", *op. cit.*

¹⁰ Medetskii´, "Moscow promises", *op. cit.*

to ensure that the transition to market prices was as progressive as possible. Thus, in a new round of talks in April (after weeks devoted to the implementation of the March agreements), Naftohaz proposed a framework of cooperation for the period 2009-2012.¹¹ However, here there appeared the most deleterious element in the upcoming negotiations: the linkage of debt resolution with pricing discussions. As an example of this dynamic, in this same round of talks, Gazprom balked at Naftohaz's proposed framework and simply insisted on discussing first a final payment for outstanding debts and the issuance of a license to Gazprom Sbyt.¹² We will have the chance to track this dynamic below.

8. 2. Naftohaz Tries to Secure an Agreement with Gazprom and Debt Problems Persist

With the latest debt problems solved by May (apparently, as will be seen below), the Ukrainian side seemed to have the road open for further negotiations on the dreaded price transition. After the framework proposed in April, the Ukrainian government now instructed Naftohaz to sign a delivery and transit agreement valid for 15 years with Gazprom, where RosUkrEnergo would be removed and where a five-year transition to market prices was to be agreed.¹³ The perspectives for Naftohaz were not particularly negative, as Gazprom also accepted in principle a progressive calendar. Gazprom intended to set 2011 as the final year for the introduction of market indexation and for putting prices in the CIS space on a par with those in Europe.¹⁴ This had already been agreed with some CIS countries like Belarus, Moldova and Armenia.¹⁵ There was thus no obvious mismatch between Gazprom's strategy and this latest offer from the Ukrainian side. However, this was probably only a starting position to prepare for negotiations. In fact, Naftohaz's Head, Oleg Dubina had not specified yet which would be the transit tariff demanded. He simply tied it to subsequent negotiations¹⁶ while mentioning the current price of US\$179.5tcm as the

¹¹ Ivzhenko, Tat'iana: "Voï'na ul'timatumov (война ультиматумов)", *Nezavisimaia Gazeta*, 24 April 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

¹² *Ibid.* (As it may be remembered, Gazprom Sbyt was the trader from Gazprom supposed to have direct access to the Ukrainian energy market).

¹³ "Ukraina dogovoritsia s Rossiei' po gazu na 15 let (Украина договорится с Россией по газу на 15 лет)", *Kommersant*, 8 May 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

¹⁴ Mazneva, Elena and Kashin, Vasilii': "Zamorozit' tseny (Заморозить цены)", *Vedomosti*, 8 May 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

¹⁵ "Goriachaia pora (Горячая пора)", *Vedomosti*, 21 May 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

¹⁶ Mazneva and Kashin, "Zamorozit' tseny", *op. cit.*

starting price for such transition.¹⁷ The fact that both Gazprom and Naftohaz agreed on a progressive calendar was in itself very positive.

In line with its strategy, Gazprom communicated in mid-May that it expected Ukraine to assume market prices by 2011-12.¹⁸ This was relatively positive for Ukraine as it confirmed Gazprom's flexibility (see paragraph above). This also reduced fears of any steep price increase resulting from Central Asian suppliers' new pricing policy.¹⁹ However, any progressive calendar depended on the margin left by Central Asian supplies, something that was not known yet in firm. That same month, a CIS Summit at Minsk took place: Timoshenko's claim to have agreed with Gazprom an early start for discussions fed expectations that a long-term agreement might be reached in summer. A positive disposition also seemed to be shared by the now Prime Minister Putin (Dmitry Medvedev having taken over the presidency), who in principle accepted something dear to the current politicians in charge in Kiev: future supplies would be direct without RosUkrEnergo's intermediation.²⁰ However, Putin also made clear the condition *sine qua non* for reaching an agreement on this issue: to solve any debt issues.²¹

The curse of debt problems resurfaces: the linkage is established with pricing negotiations

If we wrote a page above, that debt issues deriving from the recent dispute in February-April were already solved, debt in fact emerged again: the Russian side stated that neither prepayment for May had been made yet nor had Naftohaz fully paid for April. There was talk of a rough figure of more than US\$1bill of new debt.²² If Russia did not push too hard on this issue, some suspected it was because Gazprom might be ready for concessions in order to avoid Ukraine's obstruction of Russian accession into the WTO,²³ but the issue would soon become central.

One month later, in June, a meeting took place between the heads of Gazprom and Naftohaz, and the debt that had been "discovered" some weeks ago made its comeback: Gazprom presented Naftohaz a bill of US\$700-US\$800mill of gas (for April and May) and made explicit the linkage between its

¹⁷ Ivzhenko, Tat'iana: "Piatiletka l'gotnikh tsen (ПЯТИЛЕТКА ЛЬГОТНЫХ ЦЕН)", *Nezavisimaia Gazeta*, 12 May 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

¹⁸ "'Gazprom': tsena na gaz dlia Ukrainy v 2011-2012 godakh priblizitsia k evropei'skoi' ('ГАЗПРОМ': ЦЕНА НА ГАЗ ДЛЯ УКРАИНЫ В 2011-2012 ГОДАХ ПРИБЛИЗИТСЯ К ЕВРОПЕЙСКОЙ)", *Nezavisimaia Gazeta*, 21 May 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

¹⁹ Kulikov, "Gazprom" gotov poi'ti", *op. cit.*

²⁰ Kashin, Vasilii: "Gazovyi pakt (Газовый пакт)", *Vedomosti*, 26 May 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

²¹ *Ibid.*

²² Grivach, Alexei: "Ot Timoshenko zhduť ritmichnosti (От Тимошенко ждут ритмичности)", *Vremia Novostei*, 26 May 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²³ Kal'matskii, Mikhail: "Paralleli pereseakaiutsia (Параллели пересекаются)", *Novye Izvestiia*, 26 May 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

immediate payment and any talks regarding new contracts for future supplies.²⁴ Besides that, it appeared that the payment for Russian gas supplied early that year remained unsolved. The reason was that the swap that had been agreed before as a mechanism for payment depended on the clarification of the ownership of gas located in Ukraine's storage facilities. It was suspected that the ownership of as much as 15.5bcm of gas could not be fully ascertained.²⁵

Trying again to untangle the doomed Russia-Ukraine-Central Asia triangle

With this new debt issue blocking negotiations, the new Russian President, Dmitry Medvedev (With Gazprom providing support), threatened with new prices around US\$400tcm for next year.²⁶ In an informal meeting of CIS leaders in Saint-Petersburg on 6th June 2008, Medvedev warned of an impending rise for 2009, due to new Central Asian prices and referred to final prices for Ukraine amounting to US\$350-US\$360tcm, roughly double what Ukraine was paying for 2008 (US\$179.5tcm).²⁷ This contrasted with information published on 7th June 2008 by *Gazeta*, where there was talk of a more acceptable price range secretly agreed between Gazprom and Turkmenistan at around US\$200-US\$230tcm.²⁸ However, the truth is that an agreement on Central Asian gas would not happen until the very end of the year. Back to uncertainty and maximalism, Alexei Miller reiterated on the eve of a meeting between Vladimir Putin and Yulia Timoshenko in Moscow the possibility of prices going well

²⁴ Grib, Natal'ia and Gavrish, Oleg: "Ukrainu vystavili so schetom (Украину выставили со счетом)", 6 June 2008 (Accessed on 17th August 2011, from East View, Harvard Libraries).

²⁵ *Ibid.*

²⁶ Grib, Natal'ia: "Chernomorskii flot vyros v tsene na gaz (Черноморский флот вырос в цене на газ)", *Kommersant*, 7 June 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries). It must be pointed out though that as *Kommersant* suspected, this was a rhetorical retaliation for Ukraine's plans not to renew the lease for Russia's Black Sea Fleet in Sebastopol and Yushchenko's plans to establish energy corridors bypassing Russia. In August, President Yushchenko struck back with this issue, instructing that the debt Ukraine still owed the Russian Federation from the 90s should be repaid (see: Ivzhenko, Tat'iana: "Razmen flota na gaz (РАЗМЕН ФЛОТА НА ГАЗ)", *Nezavisimaia Gazeta*, 16 September 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries). This was echoed again by the Ministry of Foreign Affairs in September (see: "Timoshenko orders ministry to work on early debt repayment bid", *Itar-Tass*, 25 September 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries), even if there was confusion as to whether this referred to the debt mentioned earlier by the President or to current gas debts. In any case, with gas debts from the 90s having been used by Russia as a means to secure favorable treatment for the Black Sea Fleet, the repayment of that debt now, used then in exchange for the lease agreement of Sebastopol's naval base, was meant to renegotiate the current status in favor of Ukraine. This should be clearly linked to Yushchenko's threat to restrict the movements of the Russian Fleet made in the aftermath of Russia's war against Georgia.

²⁷ Grivach, Alexei: "Shokovoe ozdorovlenie (Шоковое оздоровление)", *Vremia Novostei*, 7 June 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁸ Gavshina, Oksana: "Kubometricheskaia sistema mer (КУБОМЕТРИЧЕСКАЯ СИСТЕМА МЕР)", 7 June 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries). In 2008, Gazprom had bought Central Asian gas at US\$140tcm from Turkmenistan, US\$160tcm from Kazakhstan and US\$145tcm from Uzbekistan.

beyond US\$400tcm.²⁹ The average price expected for European customers at market prices was suspected as likely to reach as much as US\$500tcm by the end of 2008.

There were new speculations regarding Central Asian gas when President Medvedev travelled to Turkmenistan in early July. It was leaked that Gazprom would have offered prices at US\$360tcm. More optimistically the analyst Maksim Shein from *Broker Investment* calculated this proposal only as a starting position in negotiations. He calculated that the final price would in fact be around US\$280-US\$300tcm.³⁰ If true, even these prices might not provide a suitable solution, as roughly at the same time Naftohaz was fixing US\$250tcm as the maximum price acceptable for the next year.³¹ As a result of a visit to Ukraine by Alexei Miller where no tangible results transpired, Timoshenko was to claim a progressive timetable for prices had been agreed.³² Many commentaries at the time pointed to the seemingly good relations between Putin and Timoshenko. This arguably reinforced the credibility of such announcement. This also fed, by the way, rumours from the entourage of President Yushchenko according to which, plans existed between Timoshenko and Gazprom to recreate the international gas consortium from Kuchma's times.³³ Particular episodes like this, manifesting the opposition between the Ukrainian President and Prime Minister and so conspicuous in the previous dispute (See chapter 7) are worth mentioning, as they might have played a determining role in the genesis of the dispute, as we will see later.

But in fact, what could really be said of these positive signs? The joint trip to Germany to meet the President of *Deutsche Bank*, Joseph Ackerman by both Alexei Miller and Oleg Dubina suggested after all that the thaw staged by the two heads of government might be real. This trip opened up very good prospects for Naftohaz, as a credit line by the German bank could solve many of the financial problems

²⁹ "Russia's Putin, Ukraine's Timoshenko, to discuss gas contracts", *Itar-Tass*, 28 June 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³⁰ Grib, Natal'ia and Gavrish, Oleg: "'Gazpromu' vzvinchivaiut tsenu ('Газпрому' взвинчивают цену)", *Kommersant*, 9 July 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

³¹ *Ibid.* Later, the Ukrainian Presidential office would intervene in the energy debate calling the government to consider that prices for 2009 would hardly be under \$300tcm, in contrast to prospects of a price range of US\$250-260tcm considered by the government (see: "Sekretariat prezidenta Ukrainy schitaet real'noi' tsenu na gaz ne menee 300 dollarov (Секретариат президента Украины считает реальной цену на газ не менее 300 долларов", *Vremia Novostei*, 17 September 2008 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

³² "Ukraine, Russia agree on gradual transition to market gas price – PM", *Itar-Tass*, 23 July 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³³ Ivzhenko, Tat'iana: "Truba vedet Kiev v tupik (ТРУБА ВЕДЕТ КИЕВ В ТУПИК)", *Nezavisimaia Gazeta*, 21 August 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries). It was even stated that the consortium would be announced in October when a final agreement on future prices and a long-term contract had been reached between Gazprom and Naftohaz; the government of course denied such claims (see: "Iuliia Timoshenko: 'Gazotransportnaia sistema dolzhna ostat'sia v soobstvennosti Ukrainy (Юлия Тимошенко: 'Газотранспортная система должна остаться в собственности Украины')", *Vremia Novostei*, 21 August 2008 (Accessed on the 22nd August 2011, from East View, Harvard Libraries), which eventually proved spurious, indeed.

the Ukrainian monopoly was facing.³⁴ That this trip was made in cooperation with Gazprom spoke of a possibly substantial change in its attitude. A new credit line coincided after all with the Russian monopoly's interests: as the Prime Minister Timoshenko herself acknowledged, talks with DB pursued the goal of securing financial means for Naftohaz to purchase gas to guarantee that Ukrainian storage facilities were correctly filled to face demand.³⁵ This seemingly good course might have been further confirmed by Oleg Dubina's declarations to Bloomberg: Dubina dropped the threat of raising the transit tariff, "*as these would translate into higher prices for Ukrainian consumers*" and showed confidence that prices in 2009 would not be higher than in the three previous years (as prices increased in 2006, 2007 and 2008, it can be surmised that he meant that prices would increase at a similar rate to these three years).³⁶

Back to the contentious debt issue, and with talks not moving further than generic promises and the usual threats and counter-threats, new controversies surfaced. The complexity of relations between Gazprom, Naftohaz and the web of intermediaries was easily used as an excuse for blaming others. This was the same that had happened before the March 2008 dispute. As an example, Oleg Dubina fallaciously stated that Naftohaz was not to blame; on the contrary RosUkrEnergo was the sole guilty party for the existing debt to Gazprom. RosUkrEnergo obviously claimed a debt exceeding US\$2bill (former Head of Naftohaz, Evgenii' Bakulin, calculated that the whole debt, including the new figures raised in June regarding non-payments for April and May (US\$700-US\$800mill), amounted to as much as US\$2.5 bill)³⁷ had its origin in Naftohaz.³⁸ Naftohaz in fact would eventually at least acknowledge a total amount of US\$897mill owed to RosUkrEnergo (that corresponding to April and May).³⁹

³⁴ Grivach, Alexei': "'Gazprom" pomozhet "Naftogazu" rasplatit'sia ("Газпром" поможет "Нафтогазу" расплатиться)", *Vremia Novostei'*, 12 September 2008 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

³⁵ Trempel', Aleksandr: "Kiev privlekaet sredstva na zapolnenie gazokhranilishch (Киев привлекает средства на заполнение газохранилищ)", 15 September 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries); thus would stave off any disturbances in the flow of Russian gas to Europe.

³⁶ Grivach, Alexei': "Tranzitnaia postoiannaia (Транзитная постоянная)", *Vremia Novostei'*, 19 September 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries). However, other declarations by the same Dubina before, cast a shadow on the negotiating style Naftohaz meant to pursue: in a quite defiant note, the Head of the Ukrainian monopoly had stated that the company's interests lay in dragging out negotiations as much as possible, even until 31st of December, as the general downward trend of oil prices in the world market as a result of the Great Economic Recession that was starting would ensure lower prices the later these were agreed. This was a quite worrisome declaration and it fits with what eventually happened at the end of 2008.

³⁷ Kashin, Vasili' and Shpigel', Maria: "Kto komu dolzhen za gaz (Кто кому должен за газ)", *Vedomosti*, 8 July 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³⁸ "Naftogaz Ukrainy's debt to RosUkrEnergy exceeds USD 2 bln", *Itar-Tass*, 7 July 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³⁹ Trempel', Aleksandr: "'Naftogaz" utverzhdaet, chto ego dolg RosUkrEnergo ne prevyshaet \$897 mln ("Нафтогаз" утверждает, что его долг RosUkrEnergo не превышает \$897 млн)", *Gazeta*, 9 July 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

Things seemed to become even worse when Gazprom claimed Ukraine had been extracting gas volumes beyond those contracted between the 1st and the 7th of July.⁴⁰ This occurred precisely in the context of persistent concerns by Gazprom about Naftohaz's fulfillment of the previous agreement from March regarding the return of 1.4bcm of Russian gas consumed in the first quarter of the year and RosUkrEnergo's complaints that though acknowledged, Naftohaz seemed to refuse to pay for the latest debt of US\$890mill.⁴¹ This announcement by Gazprom was certainly not a trivial one: according to information from *Kommersant*, the total amount of gas extracted above contract in July amounted to more than 1bcm.⁴² Sources from Gazprom on which the daily relied, pointed to this as a strategy to accumulate gas before prices skyrocketed in 2009.⁴³ The daily revealed that restoration of normal extraction happened in fact only on 18th July.⁴⁴ More detailed reports later talked of a total of 1.14bcm of gas extracted above contract.⁴⁵ Luckily, it was reported in August that Naftohaz finally returned 1.3bcm of gas to RosUkrEnergo,⁴⁶ which according to the Ukrainian Minister of Energy Iurii' Prodan, corresponded to Russian gas consumed in the first months of the current year.⁴⁷ As for the outstanding debt of US\$890mill, it still seemed to remain unsolved.

With this latest improvement in the "debt front" and with the hype of an agreement Timoshenko-Putin nurtured by good news during the summer, the agreement that was actually reached in October and with which starts the epigraph below, looks like an obvious outcome. However, as I have already pointed above, with neither debt issue fully solved and without a final agreement in Central Asia, these efforts came to nil. The pages below will show on the contrary a continuous worsening of the situation until gas is cut off on the 1st January 2009.

⁴⁰ Trempel', Aleksandr: "Ukraina opiat' beret lishnii' gaz (Украина опять берет лишний газ)", *Gazeta*, 21 July 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

⁴¹ Grivach, Alexei': "Lishnie sutochnye (Лишние суточные)", *Vremia Novosti*, 21 July 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁴² Mordiusenko, Olga and Grib, Natal'ia: "Ukrainu ulichili v nezakonnykh nakopleniakh (Украину уличили в незаконных накоплениях)", *Kommersant*, 21 July 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁴³ *Ibid.*

⁴⁴ *Ibid.*

⁴⁵ Gorupai', Oleg: "Missiia nevypolnima? (МИССИЯ НЕВЫПОЛНИМА?)", *Krasnaia Zvezda*, 22 July 2008 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

⁴⁶ "Ukraine returns over 1 bln c m of gas to RosUkrEnergo", *Itar-Tass*, 2 August 2008 (Accessed on 31st August 2011, from East View, Harvard Libraries).

⁴⁷ Savinykh, Anastasia: "Ukraina vernet dolgi gazom (Украина вернет долги газом)", *Izvestiia*, 5 August 2008 (Accessed on 19th August 2011, from East View, Harvard Libraries).

8. 3. The October Memorandum Illusion and the Trap of Debts

Prime Minister Timoshenko made her latest visit by early October and declared she wanted to secure gas prices for 2009 lower than US\$400/tcm.⁴⁸ That was in itself an improvement from maximalist positions. The visit took place on 2nd October and seemed to be crowned by success: Ukraine and Russia signed an inter-governmental memorandum on cooperation in the sphere of natural gas transit and supplies. The agreement was intended as the prelude to a final agreement fixing prices for the next years. The Ukrainian Prime Minister announced that Naftohaz would be the sole importer from 2009, which meant that RosUkrEnergo would be removed. She also announced that a three-year timetable had been agreed to carry out a progressive transition to market prices.⁴⁹ As *Zerkalo Nedeli* informed at the end of October (the daily posted on its web page a copy of the memorandum), it was foreseen that by 30th October the final agreement would be signed.⁵⁰

At the end, no agreement was signed (probably because debt issues resurfaced, as we will see below) and the issue was postponed for the following month: the next round of negotiations was scheduled for 11th November.⁵¹ In declarations to *Kommersant*, sources from Gazprom talked of a five year contract, with a transition period lasting three years as previously agreed.⁵² Prices were not (and could not) be determined yet, but Gazprom allegedly offered Naftohaz to keep the scheme of paying for Central Asian gas with added transport costs. Thus, both Russia and Ukraine were to agree that as in 2006, 2007 and 2008, Naftohaz would buy Central Asian and not Russian gas.⁵³ It was not clear that Central Asian gas would still be cheaper than Russian gas for export at market prices by 2009. However,

⁴⁸ "Timoshenko set to secure gas price for Ukraine below 400 dollars", *Itar-Tass*, 1 October 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁴⁹ "Putin, Timoshenko sign Russian - Ukrainian gas memorandum", *Itar-Tass*, 2 October 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁵⁰ Kashin, Vasilii' and Mazneva, Elena: "Gazovoe soglasenie (Газовое соглашение)", *Vedomosti*, 21 October 2008 (Accessed on 17th August 2011, from East View, Harvard Libraries). The copy of the memorandum confirmed most of what had been revealed by the Prime Minister herself after her return to Ukraine, including the exclusion of RosUkrEnergo after the debt had been cleared. It had been reported that an earlier version of the memorandum, talking of the necessity to clear debts owed to RosUkrEnergo, provided for the latter to have access to shares in the Ukrainian OblGazy (see: Kashin, Vasilii' and Mazneva, Elena: "Sdelka bez tseny (Сделка без цены)", 3 October 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries); whether this was meant to ensure RosUkrEnergo revenues to compensate for possible non-payment of the debts or was intended as part of Gazprom's attempts at making inroads into the Ukrainian internal market, the same way it had been tried with UkrGazEnergo in the 14th February agreement, cannot be ascertained. Interestingly, the memorandum provided for Gazprom Sbyt a license for the time the new agreement was in force; it was suspected that it might take on the capacity to re-export gas instead of Naftohaz, as RosUkrEnergo had assumed that capacity since the agreements of January 2006 (see: Ivzhenko, Tat'iana: "Gazprom" utverdilsia na ukrainskom rynke ("GAZPROM" UTVERDILSIA NA UKRAINSKOM RYNKE)", *Nezavisimaia Gazeta*, 27 October 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁵¹ "Naftogaz Ukraine plans to sign gas deals with Gazprom till 2019", *Itar-Tass*, 10 November 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁵² Grib, Natal'ia and Gavrish, Oleg: "'Gazprom' zafiksiruet Ukrainu na tri goda ("Газпром" зафиксирует Украину на три года)", *Kommersant*, 11 November 2008 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

⁵³ *Ibid.*

if a certain difference could be preserved in favor of Ukraine, and if falling oil prices (due to the devastating financial crisis setting in at the moment, the Brent cost US\$58 per barrel as opposed to US\$140 six months earlier)⁵⁴ restrained price hikes by Central Asian gas producers, Gazprom might have been confident that prices satisfying Ukraine were possible.

As for future prices, what were analysts predicting at the time? The following assessments were provided, which considered either Central Asian or general Russian prices. Jonathan Stern from the Oxford Institute of Energy Studies predicted an increase of US\$40tcm-US\$100tcm from what prices were at that moment (US\$179.5tcm), whereas Peter Keller from *Troika Dialog*, Kiev, pointed to lower figures put forward earlier, namely, US\$250-US\$260tcm as final prices for Ukraine.⁵⁵ Iurii´ Korovin, from *Olgaz-Investa*, Kiev, stated that given the general fall of energy prices, Ukraine might end up paying at the most US\$360tcm.⁵⁶ Sergei´ Cheplanov from Gazprom had predicted at the beginning of November that prices for Western Europe in the first quarter of 2009 would drop from US\$460tcm-US\$520tcm to US\$360tcm-US\$400tcm.⁵⁷ According to *Kommersant*, deducting the transit costs would yield for Ukraine a price no higher than US\$300tcm.⁵⁸ However, analysts could at the present stage only speculate.

Squeezed by Central Asia and debts, the Russian side hardens its position

Then Miller specifically harked back to previous threats and warned that failing to agree to a non-progressive transition to market prices would force Ukraine to pay US\$400tcm.⁵⁹ We could see such threats as a window through which to perceive Gazprom's dilemma: the Russian monopoly was squeezed between the Ukrainian economy's dependence on cheap energy and the fact that Turkmenistan, Kazakhstan and Uzbekistan no longer seemed to be ready to "play the game" of either offering cheap gas to Gazprom to be resold at market prices to Europe or to subsidize Ukraine's economy. Gazprom probably needed Ukraine only to compromise to Central Asian prices. But failing to secure such compromise, it seemed ready, as in 2005, to yield the stick of even higher prices for Russian gas.

⁵⁴ *Ibid.*

⁵⁵ Wilensky-Landford, Ethan: "Central Asia may be key to gas cost deal", *The Moscow Times*, 13 November 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁵⁶ Grib, Natal'ia: "Rossiia vydavliwaet gaz (Россия выдавливает газ)", *Kommersant*, 21 November 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries); whether this was just coincidence or the result of a good reading of the complex situation of the energy market, he actually mentioned the exact price Ukraine ended up paying in the first quarter of 2009 (see below).

⁵⁷ Grib, Natal'ia; Solov'ev, Vladimir; Sidorenko, Sergei´ and Gavrish, Oleg: "Prezident prezidentu – dolg (Президент президенту – долг)", *Kommersant*, 22 November 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries)

⁵⁸ *Ibid.*

⁵⁹ Grivach, Alexei´: "Iz Kremliia poveialo kholodom (Из Кремля повеяло холодом)", *Vremia Novostei´*, 21 November 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

However, as Natal'ia Grib from *Kommersant* pointed out, the explicit reason in Gazprom for this harshness was the immediate loss to the company that might accrue from Naftohaz's incapacity to pay its outstanding debts.⁶⁰ We should not underestimate an issue like this that had been linked for the first time to gas cut-offs as early as late 2007 (see chapter 7, p. 215), that had led to real cut-offs in March 2008 (see chapter 7, pp. 234-236) and that was arguably more important now that Gazprom was suffering the consequences of the financial crisis. To reinforce this impression, we may see in the next pages that Gazprom remained adamant against starting any negotiations regarding pricing for the next years before debts were finally cleared. The linkage would be maintained until the very end of the dispute and this threat is thus understandable in the context of Gazprom's reduced patience for Naftohaz's dismal financial performance.

Ukraine's energy security trapped in the latest debt issue

In November Gazprom started claiming a debt of around US\$2bill.⁶¹ Where did this debt come from now? As usual, there would be contending versions during the whole process, as when Gazprom demanded US\$2.4bill while Naftohaz only accepted a figure of US\$2.25bill.⁶² Somehow foreseeable was that Oleg Dubina should state, as he did in an interview to *Nezavisimaia Gazeta*, that the debt was mostly owed by RosUkrEnergo to Gazprom,⁶³ ruling out any responsibility by Naftohaz. Foreseeable too, was that Timoshenko would support Dubina's line two weeks later.⁶⁴ In line with Miller's harshness on pricing issues, President Dmitry Medvedev himself instructed Gazprom's head to exact from Naftohaz the outstanding debt by either voluntary or *compulsory procedures* (emphasis mine).⁶⁵

Alexei' Grivach from *Vremia Novostei*, in line with Natal'ia Grib's article,⁶⁶ explained this sudden hardening of the Russian position as a preventive move to forestall the risks of a default in the face of the

⁶⁰ Grib, "Rossiia vydavliwaet", *op. cit.*

⁶¹ Grib, Natal'ia and Gavrish, Oleg: "Ukraina zaplatit za Evropu (Украина заплатит за Европу)", *Kommersant*, 11 November 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

⁶² Petukhova, Ekaterina: "V kieve utolili politicheskii' golod (v KIEVE UTOLILI POLITICHESKII' GOLOD)", *Moskovskii' Komsomolets*, 24 November 2008 (Accessed on the 22nd August 2011, from East View, Harvard Libraries)..

⁶³ Ivzhenko, Tat'iana: "Bez fors-mazhorov (БЕЗ ФОРС-МАЗЖОРОВ)", *Nezavisimaia Gazeta*, 7 November 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

⁶⁴ "Ukrainian govt has debt to Russia – Gavrish", *Itar-Tass*, 21 November 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries). President Yushchenko balanced his tirade against the government and his demand for immediate repayment of the gas debt and the establishment of market-based conditions in gas relations, with a challenge to Russia to accept market prices also for the Russian Fleet in Sebastopol, gas deposit and gas transit (see: Grib; Solov'ev; Sidorenko, and Gavrish, "Prezident prezidentu – dolg", *op. cit.*).

⁶⁵ "Medvedev orders Gazprom to recover gas debt from Ukraine", *Itar-Tass*, 20 November 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁶⁶ Grib, "Rossiia vydavliwaet", *op. cit.*

catastrophic financial situation of Naftohaz.⁶⁷ Besides this, Ukraine was at the moment cast into a situation of political paralysis due to the process of dissolution of the Rada, which according to Dmitrii´ Boiarchuk from the Ukrainian think-tank CASE, might block compensations from the state budget Naftohaz.⁶⁸ Vitaly Varishchuk of *Dragon Capital investment* pointed to the fact that in any case, given the financial situation, such payment would simply impose a huge burden on Ukraine.⁶⁹

In the meantime, contradictions regarding the amount of the debt persisted: contradicting dismissive statements by his superior, the Vice-Chairman of the board of Naftohaz, Vladimir Trikolich, acknowledged there did exist a debt owed to RosUkrEnergo, but still disagreed with Gazprom, as he only acknowledged US\$1.26-US\$1.27 bill.⁷⁰ In a press release as reported by *Itar-Tass*, the exact figure acknowledged by Naftohaz was US\$1.267bill.⁷¹ RosUkrEnergo from its side presented the following breakdown of the debt: Naftohaz's calculation, as presented by Trikolich took into consideration US\$400mill from September and US\$900mill from October. If adding non-payment for November which also amounted to US\$900mill and taking into account both US\$200mill of fines for past months and an additional US\$100mill for November if the situation persisted, this matched Gazprom's figures.⁷² *Zerkalo Nedeli* provided further clarifications for the debt controversy: the weekly reported through sources in Naftohaz that the company did acknowledge the debt figures presented by Gazprom. The article provided details on the breakdown presented by RosUkrEnergo: US\$400mill for September as Naftohaz had only paid US\$285mill that month to RosUkrEnergo; US\$798.8mill for the whole month of October; then finally came US\$835mill corresponding to November and US\$250mill for delayed payments from the beginning of the year.⁷³ These whole figures accounted for the US\$2.25bill the company sources had admitted earlier and differed from the US\$2.4bill Gazprom demanded. At this stage it seemed that the crux of the contending figures was based on two elements: the exact amount of fines and the outstanding payments that could be counted as debt. In fact, *Kommersant* criticized Gazprom for counting as debt payments for October and November. According to the Russian daily, the existing rules stated that gas

⁶⁷ Grivach, "Iz Kremlia poveialo kholodom", *op. cit.*

⁶⁸ Kashin, Vasili´ and Chunareva, Marina: "Prinuzhdenie k \$2,4 mlrd (Принуждение к \$2,4 млрд)", *Vedomosti*, 21 November 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

⁶⁹ "Moscow demands Ukraine pay debts for gas ´voluntarily or forcibly´", *Itar-Tass*, 21 November 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁷⁰ Grivach, "Iz Kremlia poveialo kholodom", *op. cit.*

⁷¹ "Naftogaz Ukrainy says it has no debts to Gazprom", *Itar-Tass*, 21 November 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁷² *Ibid.*

⁷³ "Naftogaz Ukrainy admits USD 2,25 bln dent for Russian gas supplies", *Itar-Tass*, 22 November 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

could be paid until the 25th of the next month after its purchase, so neither of these could be computed as debt yet.⁷⁴

To unblock the situation, Gazprom was supposed to have offered its Ukrainian counterpart a deal to pre-pay transit services for the period 2009-2010.⁷⁵ Naftohaz would have rejected this deal. The apparent reason was that the offer came with a condition: to maintain US\$1.7bcm/100km as transit tariff for the next two years.⁷⁶ It is understandable that Naftohaz did not want to relinquish one of the weapons it had to put pressure on Gazprom. After having rejected Gazprom's offer to deduct the debt from payments due in concept of transit tariffs, Prime Minister Timoshenko announced that a request had been submitted to be granted a delay in payments.⁷⁷ Gazprom remained adamant. Naftohaz then proposed a complex scheme to pay US\$2.2bill and to acquire at the same time from RosUkrEnergo 11.5bcm at US\$200bcm, but the latter rejected the offer.⁷⁸ The Ukrainian delegation at least obtained from Gazprom a slight delay for payments for September,⁷⁹ pushing the deadline to the first of December⁸⁰ in exchange for also paying US\$550mill corresponding to October.⁸¹ The vicious circle deriving from the dire financial situation of Naftohaz led to fears that payments for December would soon add up (including new fines) to the total debt figure, which would thus amount to as much as US\$3bill.⁸² In fact, after the

⁷⁴ Grib, Solov'ev, Sidorenko and Gavrish, "Prezident prezidentu – dolg", *op. cit.* In fact *Kommersant* would clarify in a later article, that according to a copy of the 14th March agreement owned by the daily, the date was the 30th and not the 25th as earlier stated (see: Grib, Natal'ia and Gavrish, Oleg: "Gazprom" dal Ukraine otsrochku ("Газпром" дал Украине отсрочку)", *Kommersant*, 26 November 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

⁷⁵ Grib, "Rossiia vydavliwaet gaz", *op. cit.*

⁷⁶ *Ibid.* It is nevertheless debatable whether Gazprom was exploiting the opportunity to exact additional gains or whether that was the normal transit tariff if gas prices remained under market levels for that period.

⁷⁷ "Ukraine asks for delay in payment for imported gas delivered in October", *Itar-Tass*, 24 November 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries). Timoshenko equivocated specifying her request for payment delay was of several months, in fact until the gas was used; she somewhat confusedly alleged this was the usual time for payments, until Gazprom had recently decided to demand immediate payment instead (see: Gavshina, Oksana: "Naftogaz iavilsia s chelobitnoi' ("НАФТОГАЗ" явился с челобитной)", *Gazeta*, 25 November 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries). An unusually acrimonious exchange between Ukrainian President and Prime Minister took place, with the former demanding immediate payment and the latter trying to free Naftohaz of any responsibility (see: "Ukrainian press urges PM to be more active at gas talks", *Itar-Tass*, 24 November 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁷⁸ Grib, Natal'ia and Gavrish, Oleg: "'Gazprom' vyzivaet Ukrainu v sud ("Газпром" вызывает Украину в суд)", *Kommersant*, 25 November 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries). This move probably wanted to accumulate gas before prices increased in 2009 (see: Grib, Gavrish, "Gazprom" dal Ukraine otsrochku, *op. cit.*).

⁷⁹ According to sources reached by *Kommersant* (see: Grib, Gavrish, "Gazprom" dal Ukraine otsrochku, *op. cit.*), the exact figure for September was US\$428.7mill., whereas sources from Naftohaz would later talk of a lower figure of \$380mill (see: "Neftegaz Ukrainy fails debt repayment to RosUkrEnergo – spokesman", *Itar-Tass*, 2 December 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

⁸⁰ "Ukraine should fully pay its debts for gas deliveries by Gazprom", *Itar-Tass*, 25 November 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁸¹ Grib and Gavrish, "'Gazprom" dal Ukraine otsrochku", *op. cit.*

⁸² Grivach, Alexei': "Dali pauzu (Дали паузу)", *Vremia Novostei'*, 26 November 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries). More exactly, following calculations by *Vedomosti*, US\$3.057bill (see: "Novogodnii'

agreed deadline of December 1st, full payment as agreed did not ensue: RosUkrEnergo claimed to have only received US\$268.7 mill.⁸³

Pricing agreements are clearly linked to debt resolution and gas cut-offs loom in the horizon

The company's spokesperson, Sergei' Kuprianov had made clear before what was the alternative to a non-agreement when he expressed hopes that Gazprom *would not have to resort to gas cut-offs* (emphasis mine) (Gazprom eventually also threatened with turning to the International Arbitration Court in Stockholm)^{84, 85} And indeed, the fact that any pricing and transit agreement depended on the resolution of the debt issue,⁸⁶ made the possibility of gas cut-offs as in January 2006 the more possible as the debt dispute influenced the course of gas pricing negotiations. Even if it remained unknown how much Central Asian gas would cost, apparently both sides were ready to agree on a text that had been finalized in a previous meeting in Moscow and which Naftohaz planned to sign by late November.⁸⁷ It clearly seemed that the debt problem had come to monopolize negotiations.

8. 4. December and the Blockage of Debt Issues: the Prelude to an Impending Dispute

New rounds of negotiations were taking place by mid-December and Gazprom, after seeing its former proposal of advanced payments (see above) rejected for a second time,⁸⁸ offered now concessions in exchange for an increased market share (20-50% of Ukrainian energy market) for Gazprom Sbyt.⁸⁹ This new offer was also rejected by Naftohaz, who refused to let Gazprom take advantage of its financial troubles.

podarok (Новогодний подарок)", *Vedomosti*, 3 December 2008 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

⁸³ "Neftegaz Ukrainy fails debt ", *op. cit.*

⁸⁴ "Ukraine should fully pay", *op. cit.*

⁸⁵ "Gazprom hopes Ukraine debt to be settled before New Year", *Itar-Tass*, 22 November 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁸⁶ "Gazprom can't move on to direct gas supplies until Ukraine pays debt – official", *Itar-Tass*, 24 November 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries)

⁸⁷ Ivzhenko, Tat'iana: "Uspeshnye peregovory zashli v tupik (УСПЕШНЫЕ ПЕРЕГОВОРЫ ЗАШЛИ В ТУПИК)", *Nezavisimaia Gazeta*, 24 November 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

⁸⁸ Chernovalov, Aleksandr: "Poruchitel'naia istoria (Поручительная история)", *Kommersant*, 17 December 2008, at <http://www.kommersant.ua/doc/1095463> (Accessed first on the 13th May 2013).

⁸⁹ Ivzhenko, Tat'iana: "Ukraina otkazyvaetsia ot predlozhenii' "gazproma" (УКРАИНА ОТКАЗЫВАЕТСЯ ОТ ПРЕДЛОЖЕНИЙ "ГАЗПРОМА")", *Nezavisimaia Gazeta*, 17 December 2008 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

Naftohaz moved substantially forward when it managed to transfer US\$800mill on 18th December, while promising to further transfer US\$200mill more some days later.⁹⁰ This ensued some days after the Ukrainian Rada had changed the budget and transferred to the state company a total of US\$630mill.⁹¹ At the same time, trying to avoid the worst, Naftohaz started taking extreme measures in order to end consumers paying back outstanding debts. Although payments for September and October had already been made, there still remained a huge debt for November and December amounting to around US\$2bill. President Yushchenko's declarations, stating that the debt problem was solved after the latest payments incensed the Russian side, who made it clear that only full payment of the debt would avoid gas cuts from January 1st.

In order to avoid any backlash from European customers in January 2006 Gazprom proceeded with advance warnings through a prepared charm offensive. Blame was mostly laid on Ukraine while Gazprom's commitment to guarantee transit of gas through Ukraine was duly highlighted.⁹² According to Gazprom, and in the face of strong denials from their Ukrainian counterparts, Naftohaz's Head, Oleg Dubina, would have confirmed orally that no more payments could be carried through until New Year's Eve.⁹³

Thus, the fateful deadline of January 1st was drawing nearer and latest negotiations aimed at finding a solution looked more like desperate attempts with no real prospects. A new row of acrimonious reproaches happened, when Yushchenko proposed first to return gas that could not be paid (as the crisis lowered consumption, part of that gas might be of no use) and then hinted at another rescheduling of the debt.⁹⁴ This was met by absolute refusal from Gazprom, who declared to be open to using part of the supplied gas to clear debt, but never if that was returned to Russia (the scheme would involve its reselling to third countries). This suggestion was found intolerable for Prime Minister Yulia Timoshenko.⁹⁵

⁹⁰ "Ukraina perechislila Rossii \$800 mln v schet pogasheniia dolga za gaz (Украина перечислила России \$800 млн в счет погашения долга за газ)", *Kommersant*, 18 December 2008, at <http://www.kommersant.ru/doc/1095959?4643fee0> (Accessed first on the 13th May 2013).

⁹¹ "Verkhovnaia rada vydelila "Naftogazu Ukrainy" \$630 mln (Верховная рада выделила "Нафтогазу Украины" \$630 млн)", *Kommersant*, 12 December 2008, at <http://www.kommersant.ru/doc/1093232> (Accessed first on the 13th May 2013)

⁹² Natal'ia Grib, Oleg Gavrish: "Novyi' staryi' god (Новый старый год)", *Kommersant*, 19 December 2008 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

⁹³ Vasilii' Kashin, Elena Mazneva: "Ukrainu snova otkliuchaiut (Украину снова отключают)", *Vedomosti*, 19 December 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁹⁴ "Gazprom refutes Yushchenko's statement on gas debt rescheduling", *Itar-Tass*, 24 December 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

⁹⁵ "Gazprom may discuss use of gas reserves in Ukraine for debts", *Itar-Tass*, 24 December 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

Gazprom did not conceal that it did not expect to see debts repaid and thus referred again to the alternative of advanced payments for transit.⁹⁶ Ukraine would have none of this.

Uncertainty as for Central Asian prices remains

Meanwhile, negotiations concerning new prices for 2009, which were stalled as the debt problem remained unsolved, moved in uncharted waters. From one side, the uncertainty regarding prices from Central Asia persisted by late December. This clearly contrasted with previous occasions in 2007 and 2008, when the conditions were fully known, so Gazprom could more easily negotiate with Naftohaz. The memorandum of October 2nd aimed to secure prices for Ukraine for 2009 that would match, as in the three previous years, price increases originating in Central Asia. This time, as Mikhail Gonchar, Director of the Program on Energy of the Center *Nomos*, pointed, negotiations could not move substantially on the side of pricing, as Gazprom had failed to agree on a price for Turkmen gas (the most substantial item).⁹⁷ From the other side, Gazprom, which had threatened Ukraine with market prices as charged in the rest of Europe in the event of no agreement being reached by January 1st, kept toying with prices around US\$400tcm. The truth is that circumstances, determined by the devastating financial crisis rather favored Ukraine, as oil prices in free-fall had to translate into gas prices. Gas prices being usually indexed to oil prices with a 6-9 month delay, gas prices in 2009 necessarily had to fall. Thus, when there was talk of the fateful figure of US\$400tcm, such high prices could only involve the first quarter.⁹⁸ Gazprom's Vice-Chairman Aleksandr Medvedev calculated that new prices in Europe would range from US\$260-US\$300 depending on transport prices.⁹⁹ There was no indication of whether these were average annual prices or not, but taking into account US\$179.5tcm Ukraine was paying at the moment, Olexandr Shlapak, first Deputy Head of the Ukrainian Presidential Administration, seemed justified to guess that prices for Ukraine should in any case be much lower than the maximum prices mentioned by Gazprom if the

⁹⁶ ""Gazprom" nadeetsia reshit' dolgov Ukrainy bez deneg ("Газпром" надеется решить вопросы долгов Украины без денег)", *Ukrainskaia Pravda*, 27 December 2008, at <http://www.pravda.com.ua/rus/news/2008/12/27/4459207/> (Accessed on the 13th May 2013).

⁹⁷ "Predlozhenie "Gazproma" Ukraine ne vygodno – Ekspert (Предложение "Газпрома" Украине не выгодно – эксперт)", *Ukrainskaia Pravda*, 29 December 2008, at <http://www.pravda.com.ua/rus/news/2008/12/29/4459219/> (Accessed on the 14th May 2013).

⁹⁸ In fact, as it will be shown later on, when analyzing the 19th January agreement, this is more or less what happened, as prices during 2009 strongly fell after a record high for the 1st trimester: US\$360tcm; US\$270.95tcm; US\$198tcm and US\$208.5tcm (see: Pirani, Simon; Stern, Jonathan and Yafimava, Katja: "The April 2010 Russo-Ukrainian gas agreement and its implications for Europe", Oxford Institute for Energy Studies (June 2010), p. 20, at <http://www.oxfordenergy.org/pdfs/NG42.pdf>).

⁹⁹ Gavrish, Oleg: "Gazovaia ugroza uletuchilas' (Газовая угроза улетучилась)", *Kommersant*, 19 December 2008, at <http://kommersant.ua/doc/1096282> (Accessed on the 14th May 2013). Prices had risen from US\$270 to even US\$500 in Western Europe as oil prices skyrocketed before the crisis (see: Grib, Natal'ia and Gavrish, Oleg: "Ukraina ostavila "Gazprom" s dolgom (Украина оставила "Газпром" с долгом)", *Kommersant*, 5 December 2008 (Accessed on 22nd August 2011, from East View, Harvard Libraries).

country ended up accepting Russian gas.¹⁰⁰ Sergei Kuprianov himself announced in *Ekho Moskvy*, that prices for Belarus, as well the Baltic states and Moldova, should be lower, the same way he stated that it would also happen for other partners.¹⁰¹

The debt issue seems to be solved at the last moment

However, on the eve of 2009, the situation had become critical. Gazprom kept insisting the figure of US\$400tcm as a means to exert further pressure on the Ukrainian negotiators. The exact figure mentioned on 29th of December was US\$418tcm.¹⁰² Frantic negotiations on debt pursued a late hour deal to avert a new gas cut-off. Thus, it was reported on 30th December that the Ukrainian negotiating team was ready to pay US\$1,5bill¹⁰³ (75% of the whole outstanding debt), thanks to a loan from the two main state banks, Oshchadbank and Ukreximbank and in line with what the Ukrainian Minister of Energy had announced one day earlier.¹⁰⁴ Gazprom remained silent as money had not been received yet. Then finally, on 31st December, it was reported that RosUkrEnergo had received from Naftohaz the said sum of US\$1,5 bill.¹⁰⁵ As a sign that this might be enough for the time being for Gazprom to unblock price negotiations, the Ukrainian presidential envoy on international issues of energy security, Bogdan Sokolovsky, said that prices on Central Asian gas might be signed immediately.¹⁰⁶ In utmost confusion, Alexandr Medvedev claimed the Ukrainian side had rejected a "super-profitable" offer, not disclosed for the time being so as to avoid making their Ukrainians partners "feel ashamed"¹⁰⁷. Sokolovsky had been counting on prices as

¹⁰⁰ "Yushchenko suggests making Russia gas price dependant on world markets", *Itar-Tass*, 25 November 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries). The Presidential Press Secretary, Irina Vannikova went further on the 19th December, saying that Russian gas in 2009 could be sold at around US\$100tcm; Gazprom's representative Sergei Kuprianov, though, derided such wishful thinking (see: "'Gazprom': Esli Ukraina schitaet sprovedlivoi' tsenu v \$100, to idite i kupite ('Газпром': Если Украина считает справедливой цену в \$100, то идите и купите)", *Ukrainskaia Pravda*, 27 December 2008, at

<http://world.pravda.com.ua/rus/news/2008/12/27/4459193/> (Accessed on the 14th May 2013).

¹⁰¹ "'Gazprom' snizhet tsenu na gaz dlia Belarusi i drugikh ('Газпром' снижает цену на газ для Беларуси и других)", *Ukrainskaia Pravda*, 24 December 2008, at <http://www.pravda.com.ua/rus/news/2008/12/28/4459217/> (Accessed on 14th May 2013). The main difference with Ukraine in the case of Belarus, was that the latter had prices already indexed to oil (although starting at a much lower level than usual, something explained by Belarus' willingness to offer Gazprom asset ownership), and in the same way they had been increasing during 2008, they would consequently decrease in 2009 in parallel with the global slump (for prices in Belarus, see: Sadovnikov, Nikolai: "Peregazovka (Перегазовка)", *Rossii'skaia Gazeta*, 29 December 2008 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

¹⁰² "Gas price for Ukraine may be 418 dlrs per 1,000 cu m as of Jan 1", *Itar-Tass*, 29 December 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁰³ Macalister, Terry: "Russia-Ukraine crisis: Kiev inches towards deal with Gazprom", *The Guardian*, 30 December 2008, at <http://www.guardian.co.uk/business/2008/dec/30/russia-ukraine-gazprom-gas> (Accessed on the 15th May 2013).

¹⁰⁴ "Ukraine min hopes gas contract with Russia to be signed this year", *Itar-Tass*, 29 December 2008 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁰⁵ "Naftogaz transfers \$1.5 bln to RosUkrEnergo as gas debt to Russia", *Itar-Tass*, 31 December 2008 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁰⁶ *Ibid.*

¹⁰⁷ "Gazprom makes super - profitable gas price offer to Ukraine", *Itar-Tass*, 31 December 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

low as US\$130tcm, assuming a base price of Russian gas for Ukraine around US\$260tcm (which went in line with previous assessments), to which a 50% discount (was that the "super-profitable" offer allegedly discussed?), would be applied.¹⁰⁸ At this stage, it was not known anymore whether Ukraine was supposed to receive either Russian or Central Asian gas in any prospective agreement. In fact, after the free-fall in world oil prices, Russian and Central Asian gas might end up being priced similarly.¹⁰⁹

Desperate late-hour efforts to avert gas cut-offs: why could no agreement be reached?

Then a few hours later it was revealed that Gazprom was offering a price of US\$250tcm while keeping the same transit tariff of US\$1.7tcm/100km.¹¹⁰ This would have been a quite manageable price (in line with price increases Ukraine had undergone in 2007 and 2008), which Vladimir Putin himself justified as a *"token of solidarity to a fraternal people as the Ukrainian was and out of humanitarian reasons in the face of the critical economic situation"*.¹¹¹ As it transpired the next day (when the dispute had already started) Naftohaz was ready to pay US\$235tcm and raise the transit tariff to US\$1.8tcm/100km.¹¹² However, no agreement was reached when the deadline of December 31st was over. This was unfortunate, as the transfer of US\$1.5bill to RosUkrEnergo, in spite of a punctual declaration by Alexei Miller some hours after the announcement, that Gazprom "had not yet seen any money",¹¹³ seemed to have satisfied Gazprom enough to restart negotiations on prices. Besides this, Gazprom was offering

¹⁰⁸ "Ukraine says 250 dlrs per 1,000 cm of gas too high a price - source", *Itar-Tass*, 31 December 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

¹⁰⁹ In fact on the 31st, after negotiations broke down, Alexei Miller revealed that the final price Central Asian republics were to charge Gazprom for their gas would amount to US\$340tcm, turning into US\$380tcm once delivered to Ukraine (see: "Ukraine premier may see in New Year in Moscow", *Itar-Tass*, 31 December 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries). Prime Minister Vladimir Putin would restate the price of US\$340tcm in a press conference on 12th January (see: "Prem'ér-ministr Vladimir Putin: "Ja ne torguiu ni gazom, ni ogurtsami, ni pivom (Премьер-министр Владимир Путин: "Я не торгую ни газом, ни огурцами, ни пивом")", *Izvestiia*, 12 January 2009 (Accessed on the 22nd August 2011, from East View, Harvard Libraries). Although this price was coherent with the intentions expressed by Central Asian suppliers in March 2008, it is somehow puzzling that Gazprom may have been ready to offer US\$280tcm in the last stages of negotiations, as this was considerably lower than either Russian or Central prices. Miller himself justified this flexibility for "humanitarian" and economically based "pragmatic" reasons (*Ibid.*); that however is probably a mere justification.

¹¹⁰ "Ukraine says 250 dlrs per 1,000 cm", *op. cit.*

¹¹¹ "Gazprom predlagaet Ukraine gaz po \$250 ("Газпром" предлагает Украине газ по \$250)", *Ukrainskaia Pravda*, 31 December 2008, at

<http://www.pravda.com.ua/rus/news/2008/12/31/4459441/> (Accessed on the 15th May 2013).

¹¹² "Ukraine's gas monopoly says ready to buy gas for 235 dlrs", *Itar-Tass*, 1 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹¹³ "'Gazprom" tak i ne uvidel deneg i obviniaet "Naftogaz" v destruktive ("Газпром" так и не увидел денег и обвиняет "Нафтогаз" в деструктиве)", *Ukrainskaia Pravda*, 31 December 2008, at

<http://www.pravda.com.ua/rus/news/2008/12/31/4459438/>. The fact that the money had been transferred to RosUkrEnergo was in itself proof of good faith by the side of Naftohaz and it can be considered whether Gazprom did not trust RosUkrEnergo more than the Ukrainian state company or intended to sabotage negotiations. Most likely Gazprom was either contributing to the war of nerves in order to force Naftohaz to accept the latest pricing agreement, or was venting its frustration at the fact that the former had not accepted it (the timing of declarations and the course of negotiations is confusing). As already stated, the fact that talks centered on pricing and not debt, is the strongest sign that the payment had opened the way to the last stage.

surprisingly low prices and the gap between the latest positions by Gazprom and Naftohaz was quite small. It is true that the window of opportunity was very small, as the debt problem was only solved at the very latest. Sergei´ Kuprianov in fact went as far as to accuse Naftohaz of intentionally "dragging their feet", to pay as late as possible and then leave negotiations for the last hours.¹¹⁴ However, as already stated, positions had been moving during the last days, so no lengthy negotiations should have been necessary. What had then happened in these last crucial hours to make negotiations founder and waste this last window of opportunity? In the coming days, many versions started transpiring:

Prime Minister Timoshenko´s moves prevented the final agreement

Iurii´ Boiko, former Minister of Energy of Ukraine declared that the fault lay in Timoshenko´s insistence on establishing a new intermediary, based as RUE in Switzerland, called "FKRtt Universal Swissland" and supposedly linked to the Prime Minister herself. Russia having rejected the offer, this would have brought the end to negotiations.¹¹⁵ In his critique, Boi´ko went as far as to link her with persons from the Kuchma clique, as Ihor´ Bakai´ and Viktor Medvechuk.¹¹⁶ Such an accusation seemed to come as a direct answer to Timoshenko´s own version, which was the exact opposite to what her political rival stated: according to Timoshenko, Boi´ko himself and Serhiy´ Levochkin had been making the utmost efforts to preserve the existence of RUE as intermediary.¹¹⁷

A somewhat confusing version by Konstantin Borodin, Head of the Center for Energy Research (Kiev) and close to Iurii´ Boi´ko, also blamed Timoshenko and provided more details:¹¹⁸ on 31st of December Naftohaz had apparently reached an agreement on US\$235tcm and a transit tariff of US\$1.8tcm/100km in Moscow (the last known position of Naftohaz, as written above). Then Timoshenko manifested her intention to fly to Moscow,¹¹⁹ which, for whatever reason, upset Gazprom´s negotiators, who threatened to scrap the agreement (as in fact eventually happened).¹²⁰ Contrary to the version above,

¹¹⁴ "Ukraine deliberately dragged feet in gas talks - Kupriyanov", *Itar-Tass*, 31 December 2008 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

¹¹⁵ "Na Ukraine nashli novogo gozovogo posrednika (На Украине нашли нового газового посредника)", *Kommersant*, 15 January 2009, at <http://www.kommersant.ru/doc/1102810> (Accessed on the 24th September 2013).

¹¹⁶ Guzhba, Alexei´: "Iuliia Timoshenko pobespakoila posrednikov (Юлия Тимошенко побеспокоила посредников)", *Kommersant*, 15 January 2009, at <http://kommersant.ua/doc/1102847> (Accessed on the 24th September 2013)

¹¹⁷ *Ibid.*

¹¹⁸ Unfortunately access to his interview with *Liga Novosti*, whence his declarations came, could not be retrieved.

¹¹⁹ It was known that Prime Minister Yulia Timoshenko was ready to fly to Moscow and then join the negotiating team to sign the new supply contracts for (at least) 2009 and that the trip was cancelled ("Ukraine premier may see", *op. cit.*).

¹²⁰ "Gazovye peregovory sorval zvonok Timoshenko? (Газовые переговоры сорвал звонок Тимошенко?)", *Ukrainskaia Pravda*, 15 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/15/4461429/>.

some sources close to the negotiating process stated that it was actually the President's position that made the final trip impossible.¹²¹

Fault lays at President Yushchenko's side, as he hindered efforts conducing to the final agreement

A more convincing version, even if complex in the chain of incredible mishaps, is available in an article by Iuliia Mostovaia in *Zerkalo Nedeli* from 17th January, when the dispute was nearing its end: according to this version, an agreement had been reached indeed on the price of US\$235tcm and a transit tariff of US\$1.79tcm/100km and the Ukrainian Prime Minister had simply to fly to finalize the agreement putting her signature. As if any doubt at this respect persisted, the Russian ambassador, Viktor Chernomirdin, confirmed to the Ukrainian daily that Ms. Timoshenko was indeed waiting. However, according to sources close to Timoshenko herself, Oleg Dubina conveyed at 11:00 of 31st December that the agreement would be ready later at 14:00.

Then, in the meantime communications between the Prime Minister and Naftohaz's Head were interrupted. The former heard that some late-hour complications were occurring and that Naftohaz had presented its Russian counterpart with an ultimatum. Alexei Miller would have informed Prime Minister Vladimir Putin about the latest ultimatum and the latter then took the final decision to put an end to negotiations.¹²² Following again sources from Timoshenko's entourage, during the crucial interruption of communications with Dubina and while negotiations with Miller continued, Dubina would often leave negotiators in order to hold telephone conversations. At the other end Yushchenko was trying to avert the nearly agreed deal in order to keep RosUkrEnergo in business (See the version below, which is also supported by Mostovaia's article).¹²³ This goes in line with what Alexei Miller would later say, namely, that Oleg Dubina had received a direct order from the President to break up negotiations.¹²⁴

Oleg Dubina blames Gazprom

Oleg Dubina himself presented a different version, blaming Gazprom instead: according to him, it was Gazprom who retreated from the 235/1.8 agreement and came back proposing US\$250tcm and a transit tariff of US\$1.6tcm/100km. Facing such proposal, Dubina said Ukraine could not accept it and neither

¹²¹ "Russia, Ukraine PMs to hold talks on gas conflict", *Itar-Tass*, 17 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹²² Mostovaia, Iuliia: "O stoimosti oshibok i tsene nezavisimosti (О стоимости ошибок и цене независимости)", *Zerkalo Nedeli*, 17 January 2009, at http://gazeta.zn.ua/POLITICS/o_stoimosti_oshibok_i_tsene_nezavisimosti.html (Accessed on the 16th October 2013).

¹²³ *Ibid.*

¹²⁴ "Gazprom cuts off gas to Ukraine; old contract expires, new absent", *Itar-Tass*, 1 January 2009.

could it guarantee Russian gas transit in the absence of agreement. This latest statement apparently was interpreted by Gazprom as an ultimatum, which led to the end of negotiations.¹²⁵

RosUkrEnergo's role in squatting negotiations: Ihor Bakai's versions

Another interesting version of the end of negotiations and the start of the dispute puts RosUkrEnergo at the very center. Timoshenko declared on 17th January, that "*during the last two days of the year, Ukraine's all political forces corruptly (sic) connected with the shadow intermediary RosUkrEnergo took part in it (negotiations)... they prevented signing of all the contracts and destroyed the negotiating process settled with such difficulty*".¹²⁶

Ihor Bakai', first Head of Naftohaz closely associated with Leonid Kuchma and who had left Ukraine for Russia fleeing from justice offered an explanation also centered on RosUkrEnergo: according to him, a dispute emerged between RosUkrEnergo and Naftohaz concerning the ownership of gas in storage in Ukraine. The dispute centered on a volume of 11bcm¹²⁷ and was followed by a strange maneuver by RosUkrEnergo, who directly intervened in negotiations offering higher prices than those accepted by Naftohaz. Instead of US\$235tcm, which was the highest Naftohaz was ready to agree to, RosUkrEnergo offered as much as US\$285tcm,¹²⁸ even more than the US\$250tcm Gazprom demanded at the final stages of negotiations.¹²⁹ Bakai' provided many details in his interview with *Zerkalo Nedeli*: President Yushchenko himself torpedoed an agreement for US\$235tcm and a transit tariff of US\$1.76tcm/100km for the first quarter of 2009, simply assuring that given the existing reserves of gas, there was no need to rush for agreement. Then, it was thought that the debt would be paid thanks to gas owned by RosUkrEnergo through a complex scheme.

Versions from the Russian side: Miller and Putin

Both versions, that by Iuliia Mostovaia and the one by Ihor Bakai' put Yushchenko in a rather bad picture. In both versions he was directly blamed for the final breakdown of negotiations precisely when an agreement had mostly been reached.

¹²⁵ Mostovaia, "O stoimosti oshibok", *op. cit.*

¹²⁶ "Ukrainian PM leaves for Moscow", *Itar-Tass*, 17 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹²⁷ "Bakai' nazval prichiny sryva ukrainsko-rosii'skikh peregovorov o postavkakh gaza (Бакай назвал причины срыва украинско-росийских переговоров о поставках газа)", *Zerkalo Nedeli*, 17 January 2009, at http://gazeta.zn.ua/POLITICS/bakay_nazval_prichiny_sryva_ukrainsko-rosiyskih_peregovorov_o_postavkah_gaza.html (Accessed on the 26th September 2013).

¹²⁸ *Ibid.*

¹²⁹ It must be said that these accusations came right after Boi'ko had accused Bakai', along with Medvechuk and Timoshenko herself, of being behind the obscure FKRT Universal Swissland, so this version could have been meant as a revenge.

Alexei Miller confirms Yushchenko and RosUkrEnergo's deleterious roles in negotiations

A third testimony, this time by Alexei Miller, interviewed by *Itar-Tass* in the aftermaths of the dispute, also blamed Yushchenko: Miller confirmed RosUkrEnergo's insistence at offering US\$285tcm instead of US\$235tcm, as initially agreed and blamed Yushchenko for having recalled Naftohaz's delegation in spite of the manifest interest from the Russian side to continue negotiations.¹³⁰ Timoshenko also referred after the dispute to this episode in an interview to *Zerkalo Nedeli*: she did not offer any new details but confirmed both RosUkrEnergo's role as a saboteur and the Presidential Administration's prominence in its strategy of supporting the presence of the infamous gas trader in direct opposition to the government.¹³¹

Clarifications from the side of Vladimir Putin

Prime Minister Vladimir Putin himself did on the contrary provide some interesting details: on the eve of the final agreement that put an end to the dispute in January he told *Novaia Gazeta* that he was at the time surprised that the price of US\$250tcm was not accepted.¹³² He also mentioned that during negotiations there was insistence from at least some in the Ukrainian side on keeping RosUkrEnergo.¹³³ Why did not Putin refer to the US\$235tcm agreed on the eve of the dispute as the two versions above state? Might this in fact lend credence to Dubina's version of US\$250tcm and US\$1.6tcm/100km as the final offer? Not necessarily. Putin also provided the following information: the Russian negotiating team had offered US\$285tcm with a right to re-export, which the Ukrainians deemed too expensive. Then Gazprom made a new offer: US\$250tcm with the same right to re-export. However, this last offer was again refused by the Ukrainians.¹³⁴ Interestingly, Putin stated that in practical terms US\$250tcm with a right to re-export amounted to a real price of US\$235tcm.¹³⁵ Whether this latest version is just tailored to justify *post-factum* Gazprom's gas cut-off and to simply put in unfavorable light the Ukrainian team (and the politicians behind), is hard to tell given the secrecy of negotiations. Still, this is the best candidate to provide a clarification for the confusion between US\$250tcm and US\$235tcm as the final Russian offer. What is interesting in this version of the facts is that the obscure proposal of US\$285tcm did not come

¹³⁰ "RosUkrEnergo was frustrating talks with Naftogaz - view", *Itar-Tass*, 20 January 2009 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

¹³¹ Mostovaia, Iuliia: "Kompromiss. I zhizn posle nego (Компромисс. И жизнь после него)", *Zerkalo Nedeli*, 24-30 January 2009, at http://gazeta.zn.ua/POLITICS/kompromiss_i_zhizn_posle_nego.html (Accessed on the 24th of October 2013).

¹³² Ivzhenko, Tat'iana: "Gazovyi' krisis zakonchilsia? (Газовый кризис закончился?)", *Novaia Gazeta*, 19 January 2009 Accessed on the 18th August 2011, from East View, Harvard Libraries).

¹³³ *Ibid.*

¹³⁴ Kolesnikov, Andrei': "S chuvstvom vypolnennogo torga (С чувством выполненного торга)", *Kommersant*, 19 January 2009, at <http://www.kommersant.ru/doc/1104978> (Accessed on the 17th October 2013).

¹³⁵ *Ibid.*

last but before the final offer, which contradicts previous versions. In this respect, only speculation is possible.

8. 5. The January 2009 Energy Dispute Starts: Gazprom Imposes Total Gas Cut-Offs

On the January 1st 2009 Gazprom decided, as three years ago, to stop supplies to Ukraine in the face of the absence of any pricing agreement. The decision was carried out at 10.00 am. Expecting gas disruptions, Vladimir Putin mentioned a transit contract signed in April 2007 (valid until 2010) warning the Ukrainian side against any attempt at disrupting the gas transit in retaliation.¹³⁶ Legal issues were relevant as there was a particular element which remained contentious: the responsibility for supplying gas to maintain the transit of the rest of gas, known as technical gas and which is consumed in order to power the transit system. Ukraine claimed it was Gazprom's responsibility and that it had the right to use a daily volume of 21mcm from Gazprom's gas transiting Ukraine.¹³⁷ Gazprom, through Sergei Kuprianov, strongly rejected Ukrainian arguments stating that ensuring transit was Naftohaz's responsibility.¹³⁸ As a joint declaration by both Yushchenko and Timoshenko made clear, there was no physical need to use this source of gas for Ukraine's consumption, as owing to their own gas reserves Ukrainian customers were protected from any disruptions, and that, for the whole heating season.¹³⁹ These two elements need a short explanation:

¹³⁶ "Gazprom cuts off gas to Ukraine", *op. cit. Itar-Tass* was reporting in one of the press reports at the start of the dispute that there was no real contract of the sort (see: "Ukrainian oil/gas co using 21 mln cu m of gas to ensure Russian transits", *Itar-Tass*, 1 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries). In fact, Valentin Zemlianskii stated there was a frame document valid until 2011 which envisioned a transit of 110 billion cubic meters, but no supplementary agreement dealing with the technical and legal conditions (see: "Naftogaz Ukrainy reduces gas transit", *Itar-Tass*, 3 January 2009 (Accessed on the 27th August 2011, from East View, Harvard Libraries). Gazprom later based its intention to appeal to the Arbitration Court of Stockholm on a framework document signed in 2002 and valid for ten years (see: "Gazprom files lawsuit against Naftogaz Ukrainy", *Itar-Tass*, 3 January 2009 (Accessed on the 27th August 2011, from East View, Harvard Libraries). Putin would produce in front of journalists in a press conference on 8th January, a copy of an alleged transit agreement signed earlier in autumn 2008 (see: "Harding, Luke: "Putin summons journalists to tell them: it's not the Kremlin's fault", *Guardian*, 9 January 2009, at <http://www.guardian.co.uk/world/2009/jan/09/russia-ukraine> (Accessed on the 8th July 2013).

¹³⁷ "Ukrainian oil/gas co using 21", *op. cit.*

¹³⁸ "Gazprom increasing gas deliveries bypassing Ukraine - Kupriyanov", *Itar-Tass*, 2 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹³⁹ "Zaiavlenie Iushchenko i Timoshenko otnositel'no postavok i tranzita rossiiskogo gaza (Zayavlenie Yushchenko i Timoshenko otnositel'no postavok i tranzita rossiiskogo gaza)", *Ukrainskaia Pravda*, 1 January 2009, at <http://www.pravda.com.ua/rus/articles/2009/01/1/4459460/> (Accessed on the 1st July 2013). As can be seen here (Parfitt, Tom: "Home fires carry on burning as presidential rivals bicker over policy", *The Guardian*, 2 January 2009, at <http://www.guardian.co.uk/world/2009/jan/02/russia-ukraine> (Accessed on the 2nd July 2013), Naftohaz was supposed to have 13bcm stored, along with a further amount of 11bcm owned by RosUkrEnergo, which should have sufficed for three months.

The controversy of technical gas

Given the secrecy of the agreements signed between Gazprom and Naftohaz, it is still not known who really bore responsibility for technical gas. The fact is that if the volumes required for technical needs were included in the gas supplied by Gazprom to Ukraine as consumer, Naftohaz had the ultimate responsibility for this. However, if Gazprom supplied it in addition with gas for Ukraine, namely, alongside the volumes exported for other consumers through the country, then Gazprom should not have failed to provide this gas. This of course is not relevant for the analysis of the dispute, as it is important to know how Gazprom would react to gas disruptions, which in fact, due to this (intended or unintended) confusion, unavoidably took place. However, the fact that volumes disrupted coincided with those calculated for technical needs lends credence to Ukraine's pretension of not being siphoning off gas as a strategic weapon.¹⁴⁰

However, the initial pretension by Naftohaz that during the 1st of January it had been using 17mcm from its own reserves, 10mcm for consumption in Europe and 7mcm as technical gas was somehow contradictory.¹⁴¹ Suspicions regarding Naftohaz were not dispelled by news of an alleged letter sent by Naftohaz and published by *Ekho Moskvu*, warning (if not actually threatening) of a possible confiscation of all gas transiting Ukraine.¹⁴² Kuprianov provided some details when he claimed Gazprom had requested permission for 303mcm to transit on the 3rd of January. The Ukrainian side allegedly only accepted 296.2mcm.¹⁴³ Was this an intended attempt to provoke disruptions and blame them on Gazprom? Unfortunately, it is still at this stage hard to know which version is correct. Even if we do not know who bore ultimate responsibility from a strictly legal point of view, Alexandr Medvedev claimed that after having ratified the Energy Charter Ukraine had obligations regarding transit.¹⁴⁴ This cannot be fully ascertained unless we have a clear picture of what the contracts stated and how the Energy Secretariat would have judged Ukraine if it had proceeded in good faith in the face of Gazprom's alleged irresponsibility.

¹⁴⁰ Unless Naftohaz bore responsibility for technical gas and was thus responsible for providing it without any disruption from its own storage, this was indeed the case. In January 2006 on the contrary, Naftohaz seems to have used more gas than necessary, instead of using gas from its own reserves, which might have been a conscious attempt to damage Gazprom's reputation. That this time volumes siphoned-off matched technical needs, as already stated, seems coherent with a scrupulous respect of existing legality.

¹⁴¹ "Naftogaz ne priznaet dolg v 614 mln dollarov (Нафтогаз не признает долг в 614 млн долларов)", *Ukrainskaia Pravda*, 2 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/2/4459577/> (Accessed on the 1st July 2013).

¹⁴² "Naftogaz i Gazprom: Perepiska (НАФТОГАЗ и ГАЗПРОМ: переписка)", *Ekho Moskvu*, 1 January 2009, at <http://www.echo.msk.ru/blog/echomsk/563350-echo/> (Accessed first on the 1st July 2013).

¹⁴³ "Gazprom increasing gas deliveries", *op. cit.*

¹⁴⁴ "Naftogaz Ukrainy reduces gas transit", *op. cit.*

The geographical location of gas storage facilities in Ukraine

Some days later into the crisis that was to unfold, Valentin Zemlyansky, Naftohaz's spokesman, provided a technical justification for Naftohaz to siphon off gas: as stores were located in the West, it would have been impossible to pump gas in reverse mode to the East as Russian gas was flowing from the opposite direction; the only solution was to take it from the incoming volumes of gas.¹⁴⁵ Unfortunately, whether this explanation was correct or not, it did not ultimately clarify whose fault this was from the legal point of view. It is nevertheless an opportune way to link up to the second contentious element, the existence of Ukraine's gas reserved.

Indeed, and as we may have had the opportunity to point out already in the two previous chapters, the issue of filling up storage facilities in Ukraine before the start of winter was of utmost importance and had provoked some tensions already. Most of the Ukrainian storage facilities are located in Western Ukraine and are filled with gas bought by Naftohaz during the previous year. However, this gas is not consumed by Ukraine, it is always consumed by countries further West, clients of Gazprom. The explanation for this is that in winter a swap between Gazprom and Naftohaz takes place: Gazprom can use the stored gas for its other consumers West of Ukraine and gives additional amounts to Ukraine in exchange directly from Russia. The reason for having established this system, inherited from the Soviet Union, is to guarantee a simultaneous supply to both Ukraine and other customers that need Ukraine as a transit country in peaks of low temperature. In order to avoid all supplies for Ukraine and the rest of the European customers having to transit the Ukrainian pipelines simultaneously, which might challenge its total capacity, gas is extracted from the deposits when needed and Ukraine is compensated for whatever volume extracted, as it is the legal owner.

This system represents an opportunity for Ukraine as soon as a protracted gas cut-off happens. As this gas is owned by Naftohaz, in the event of no supplies from the part of Gazprom, it can simply use them in reverse mode. In such cases, instead of flowing westwards, gas would flow eastwards for Ukrainian consumers. However, this is not compatible with any gas flowing westwards. Therefore, the emergency use of stored gas for Ukrainian consumers implies closing the pipeline system for any Russian gas and thus precludes the delivery of gas for other customers in Europe. This means two things: first, this might already have happened with technical gas, so the explanation by Zemliansky is totally plausible.¹⁴⁶

¹⁴⁵ "Gazprom blames Naftogaz Ukrainy for gas supply crisis", *Itar-Tass*, 12 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁴⁶ We avoid any categorical statement regarding this particular issue, as not all gas is exclusively stored in Western Ukraine and it is hard to know whether the volumes required for technical gas could not have been sent through alternative pipelines

Second, when Timoshenko and Yushchenko explained that Ukraine had enough resources to weather the storm they only said half of the truth they were interested in telling. They failed to mention that using pipelines in reverse necessarily involved closing the whole pipeline system to westward flows from Russia. This means that guaranteeing Ukraine's energy security implied leaving the rest of Europe, dependent as it is on Gazprom's gas transited through Ukraine, devoid of Russian supplies. As will be shown below, Ukraine in fact activated the reverse mode, but did not have to stop westward flows as these had been already stopped by Gazprom. However, the activation of the reverse mode might have prolonged the dispute, as Gazprom claimed it could not resume normal westwards supplies because Ukraine kept all main trunks busy with gas flowing in reverse mode from its storage facilities in Western Ukraine.

Frustrated attempts at continuing negotiations in the mist of the dispute

With the gas cut off by Gazprom and the first disturbance in the normal flow of gas happening due to the controversy of technical gas, the energy dispute had started. In this first moment of the dispute, the fateful threshold had been overstepped. However, in light of some statements, it seemed that the door might still be open to further negotiations and an eventual agreement.

In this line, Valentin Zemlianskii' stated that a new delegation might go to Moscow on January 1st to continue negotiations, while Alexei' Gudyma, the Prime Minister's advisor on fuel and energy problems, said that Timoshenko herself could travel to Russia in the coming days.¹⁴⁷ From the side of Bogdan Sokolovskii', Ukrainian President's representative for international affairs of energy security, it was stated that the Ukrainian side had in fact sent a petition in this direction for continuing negotiations on the eve of the New Year and was now awaiting a reply from Gazprom. According to the Russian embassy in Kiev, the response was in the process of being drafted.¹⁴⁸ Such statements in fact went in line with Sergei' Kuprianov's invitation for Naftohaz to come "at any time".¹⁴⁹

However, real negotiating positions did not warrant much optimism. Gazprom now only insisted on market prices, moving in fact farther and proposing a price of US\$450tcm instead of US\$418tcm as

running parallel to the main trunks. It is clear this is technically impossible if Ukraine had to cover its entire consumption in winter, but there might have been room for smaller volumes such as those required for technical gas. This is again a particular element that remains unknown.

¹⁴⁷ "Naftogaz delegation may return for talks to Moscow Thurs night", *Itar-Tass*, 1 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁴⁸ "Ukraine sends note to Russia last night to resume gas talks", *Itar-Tass*, 1 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁴⁹ "URGENT - Gazprom ready to continue talks on gas supplies to Ukraine", *Itar-Tass*, 1 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

earlier.¹⁵⁰ The Ukrainian side also lowered the threshold of acceptable prices. Depending on the sources, Yushchenko had put forward either US\$201tcm or something between US\$204tcm to US\$210tcm along with an increased transit tariff of US\$2tcm/100km to compensate for the price increase.¹⁵¹ These new prices went in fact much farther than the US\$235tcm and US\$1.8tcm/100km that represented the highest offer at the very last stage of negotiations. Oleg Dubina himself reinforced this proposal pointing to the US\$210tcm Germany was supposed to be paying at the moment for Russian gas,¹⁵² and calculating prices for Ukraine ranging from US\$201tcm to US\$202tcm once transport costs were discounted.¹⁵³ MP Arseny Yatseniuk, making similar calculations and taking into account the dramatic fall of oil prices did accept higher prices of US\$250tcm, but only under the condition of a rise of transit tariffs to as much as US\$2.8tcm/100km.¹⁵⁴

An analysis by *Ukrainska Pravda* went as far as to determine that due to the absence of any international protocol for transit, both countries should automatically revert to contracts valid in 2005; Ukraine would thus be entitled to receive 23bcm of gas in payment of transit tariffs and to raise the transit tariff to US\$9.14tcm/100km if Gazprom insisted on prices of US\$450tcm.¹⁵⁵ Along this line, Dubina in fact proposed Gazprom to return to the very framework of 2005. Besides positions on pricing, Gazprom started stressing again that part of the debt over which both countries had been haggling in the preceding weeks, remained unpaid. The remaining sum was of US\$614mill according to Sergei Kuprianov. Ukraine declined any responsibility for this sum and refused to pay. The reason for this is that most of the remaining debt was constituted by fines amounting to as much as US\$450mill Gazprom wanted to impose for late payment and which Naftohaz did not acknowledge.¹⁵⁶

¹⁵⁰ "Gazprom proposes Ukraine gas for \$450 dlrs per 1000 cu m", *Itar-Tass*, 4 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁵¹ "Zaiavlenie Iushchenko i Timoshenko", *op. cit.*; "Iushchenko soglasihsia maksimum na 210 dollarov", (Ющенко согласился максимум на 210 долларов)", *Ukrainskaia Pravda*, 1st January 2009 (Accessed on the 1st July 2013).

¹⁵² This proved later to be completely false. According to Pirani, Yafimava and Stern, average German import prices were US\$398tcm in the first quarter of 2009 (Q1 2009); the lowest prices were reached only in Q3 2009, and were still higher than those claimed by Dubina, US\$259.5tcm (see: Pirani, Yafimava and Stern, *op. cit.*, p. 20).

¹⁵³ "Naftogaz ne poshel na usloviia Gazproma iz-za ubytochnosti (Нафтогаз не пошел на условия Газпрома из-за убыточности)", *Ukrainskaia Pravda*, 1 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/1/4459499/> (Accessed on the 1st July 2013).

¹⁵⁴ "Iatseniuk: tsena v 418 dollarov - eto "prikhoti Gazproma" (Яценюк: цена в 418 долларов – это "прихоти Газпрома)", *Ukrainskaia Pravda*, 2 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/2/4459543/> (Accessed on the 1st July 2013).

¹⁵⁵ "Naftogaz" gotov podat' na "Gazprom" vstrechnyi' isk ("Нафтогаз" готов подать на "Газпром" встречный иск)", *Ukrainska Pravda*, 3 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/3/4459615/> (Accessed on the 2nd July 2013). Ukraine could only receive 23bcm if gas was priced at US\$50tcm, as Russian gas was before the 4th January 2006 (see chapter 6). If priced at US\$450tcm, a return to transit tariffs in kind would not yield as much gas.

¹⁵⁶ "Naftogaz trying to contest fines for delayed payments", *Itar-Tass*, 2 January 2009 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

As a result of this situation, respective positions became entrenched. By 3rd January 2009, Naftohaz was declaring that it did not foresee traveling to Moscow to resume talks¹⁵⁷ and both sides threatened to resort to justice. On 2nd January Naftohaz had forwarded to the European Commission the message that it planned to appeal for international arbitration to reject Gazprom's pretension to be paid US\$450mill in fines for delayed payment.¹⁵⁸ Gazprom for its own part, had taken the decision to sue Naftohaz for not providing the necessary technical gas and for siphoning it off from Gazprom's supplies.¹⁵⁹ In addition to that, RosUkrEnergo also decided to sue Naftohaz for not paying the US\$614mill it still owed.

The energy dispute provokes, as in January 2006, a supply crisis in Central and Western Europe

But as had happened in January 2006, this strictly bilateral dispute involved from the very beginning customers in Western and mainly Central Europe. As seen some pages above, the issue of technical gas provoked reduced supplies from the first day of the dispute. It is for this reason that Gazprom used many of its statements to influence European customers which might (and which would eventually) be affected by the dispute.

The Russian representative to the European Union, Vladimir Chizhov, clearly expressed Gazprom's concern for its European customers and declared that the Russian side was ready to send any delegation to Brussels and to provide for any explanation necessary.¹⁶⁰ The company's discourse was reinforced by the announcement of measures to make up for the lack of supplies. For example, when Kuprianov explained the reduction of 110mcm of gas per day (the equivalent of Ukrainian consumption not supplied since January 1st) he also announced that Gazprom would increase by a daily 236mcm its export deliveries to other customers to compensate for any disruptions the dispute might possibly cause.¹⁶¹ As relayed by *Interfax-Ukraina*, who relied on sources from the energy sector in Belarus, Gazprom had indeed started using alternative routes to increase supplies.¹⁶² Gazprom was therefore

¹⁵⁷ "Ukraine delegation has no plans to fly to Moscow over gas supplies", *Itar-Tass*, 3 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁵⁸ "Naftogaz trying to contest", *op. cit.*

¹⁵⁹ "Miller dolozhil Medvedevu o gotoviashchemsia iske na "Naftogaz" v Stokgol'mskii' sud (Миллер доложил Медведеву о готовящемся иске на "Нафтогаз" в Стокгольмский суд)", *Interfax*, 3 January 2009, at <http://www.interfax.ru/news.asp?id=55395> (Accessed on the 2nd July 2013).

¹⁶⁰ Rossiia reshila tozhe poi'ti v ataku na Evropu (Россия решила тоже пойти в атаку на Европу), *Ukrainskaia Pravda*, 2 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/2/4459575/> (Accessed on the 2nd July 2013).

¹⁶¹ "Russia cuts gas flow to Ukraine", *RFE/RL*, 1 January 2009, at

http://www.rferl.org/content/Russia_Sharp_Curbs_Gas_Flow_To_Ukraine/1365501.html (Accessed on the 1st July 2013).

¹⁶² See the article in *Ukrainska Pravda*, based on an original article in *Interfax-Ukraina*: "Cherez Belarussiiu poshlo bol'she rossiiskogo gaza. Ukraine ne pri chem? (Через Белоруссию пошло больше российского газа. Украина не при чем?)",

supplying an additional volume of 25mcm per day through Belarus.¹⁶³ Sergei Kuprianov himself later mentioned a figure of 20mcm.¹⁶⁴ As Gazprom was already expecting there might be a dispute before, it seems the decision to supply additional volumes had been taken before shortages were actually reported. In fact Gazprom was only following the same "charm offensive" it had already undertaken before the start of the dispute. It also took advantage of the occasion to promote projects like Nord-Stream and South-Stream to bypass Ukraine (see chapter 10). This, Alexandr Medvedev did in an interview to the BBC on the 2nd of January¹⁶⁵. Foreshadowing the future initiative by the EU, Gazprom also proposed the European Commission to send an independent monitoring group to monitor the flow of gas.¹⁶⁶

In any case, on 2nd January, with part of the gas not transiting through Ukraine as planned, some Central European countries were reporting lower pressure: Gazprom itself was one of the first sources to report that some Balkan countries were not receiving the full contracted volumes.¹⁶⁷ Hungary and Poland also reported lower pressure (6% for Poland); in the case of the former, the situation was yet far from critical, whereas the latter managed to compensate with the additional gas that Gazprom was supplying through Belarus.¹⁶⁸ As "Radio Free Europe/Radio Liberty (RFE/RL)" reported the next day, the fall in pressure for Poland had reached 11% and 25% for Hungary; more critically, there was a reported fall of as much as 33% of normal supplies for Bulgaria.¹⁶⁹ According to "The British Broadcasting Corporation", as relayed by Itar-Tass, a similar situation could be found in Romania with gas pressure dropping between 30% to 40%¹⁷⁰ (the Romanian "Transgaz" itself put the figure at the upper 40%)¹⁷¹. The situation could worsen as time went by, although Hungary's local company "Földgázszállító Zrt" reported as late as 4th January, that previous information regarding lower pressure was wrong, with gas flowing normally and

Ukrainskaia Pravda, 1 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/1/4459481/> (Accessed on the 1st July 2013).

¹⁶³ *Ibid.*

¹⁶⁴ "Gazprom to deliver gas to Ukraine at market price of \$ 418", *Itar-Tass*, 2 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁶⁵ See: "Russia looks to re-route EU gas", *BBC*, 2 January 2009, at <http://news.bbc.co.uk/2/hi/europe/7808937.stm> (Accessed on the 2nd July 2013).

¹⁶⁶ "Gazprom sent letter to EC on gas transit monitoring", *Itar-Tass*, 4 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁶⁷ "Russia-Ukraine gas crisis begins to impact European markets", *RFE/RL*, 2 January 2009, at http://www.rferl.org/content/Kyiv_Scrambles_To_Stem_Gas_Crisis/1365752.html (Accessed on the 2nd July 2013).

¹⁶⁸ *Ibid.*

¹⁶⁹ "EU feels impact of Russia-Ukraine gas dispute", *RFE/RL*, 3 July 2009, at http://www.rferl.org/content/EU_Feels_Impact_of_Russia_Ukraine_Gas_Dispute/1366022.html (Accessed on the 2nd July 2013).

¹⁷⁰ "Gas deliveries in Romania drop as Ukraine siphons off gas: Gazprom", *Itar-Tass*, 3 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

¹⁷¹ "Ukraine accused of stealing Russian gas as fuel flow declines", *The Guardian*, 3 January 2009, at <http://www.guardian.co.uk/world/2009/jan/03/russia-ukraine-gas-supplies-gazprom> (Accessed on the 2nd July 2013).

further transiting into the Balkan region.¹⁷² Valentin Zemlianskii' also stated that normal supplies of gas were being supplied to the Balkan region.¹⁷³ This in fact would be understandable if the gap caused by the siphoning-off of technical gas remained constant. Naftohaz kept accusing Gazprom of having consciously reduced the volumes of gas shipped in order to blame Ukraine for the consequences.¹⁷⁴ However, it seems that Ukraine had not accepted into its transit system all the supplies Gazprom had requested.¹⁷⁵ This puts Ukraine in quite a bad light, especially if that confirms that Gazprom tried to correct the mismatch of the technical gas and Naftohaz consciously averted this.

With the dispute continuing, further falls in gas pressure were reported in new countries. According again to RFE/RL, the Czech Republic had experienced by 4th January a slight drop of 5%. Turkey was also reporting similar problems regarding an equivalent drop of 5%.¹⁷⁶ On 5th January, a new country, Croatia, reported experiencing a fall of 7% in its supplies of Russian gas.¹⁷⁷ The general situation was quite confusing. Ferrán Tarradellas, The European Commission's spokesman, had reported the day before, that in spite of supply problems reported over the weekend in Hungary, Slovakia and Romania, the situation seemed to be even improving.¹⁷⁸ It is quite likely that these latest episodes of undersupply were either a delayed consequence or just the product of late reporting. It is thus reasonable to assume that at this stage, the situation remained stationary. However, the situation was to take a turn for the worse on 5th January, as Russia decided to further escalate the dispute.

¹⁷² "Ukrainskii' "Naftogaz" udivliaetsia, otkuda EC берет informatsiiu o snizhenii davleniia (Украинский "Нафтогаз" удивляется, откуда ЕС берет информацию о снижении давления", *Ukrainskaia Pravda*, 4 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/4/4459682/> (Accessed on the 2nd July 2013).

¹⁷³ "Naftogaz": postavki gaza cherez territoriiu Ukrainy v napravlenii Balkan osushchestvliaiutsia v polnom ob'eme ("Нафтогаз": поставки газа через территорию Украины в направлении Балкан осуществляются в полном объеме), *Interfax*, 4 January 2009, at <http://interfax.ru/news.asp?id=55452> (Accessed on the 2nd July 2013).

¹⁷⁴ "Naftogaz claims Russia withholds gas from Europe to accuse Ukraine", *Itar-Tass*, 4 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁷⁵ *Ibid.*

¹⁷⁶ "Ukraine accuses Russia of sabotaging Europe's gas", *RFE/RL*, 4 January 2009, at <http://www.rferl.mobi/a/1366282.html> (Accessed on the 3rd July 2013).

¹⁷⁷ "Khorvatiia nedopoluchaet 7% rossii'skogo gaza (Хорватия недополучает 7% российского газа)", *UNIAN*, 5 January 2009, at <http://www.unian.net/news/293459-horvatiya-nedopoluchaet-7-rossiyskogo-gaza.html> (Accessed on the 4th of January).

¹⁷⁸ "EU forced to tread softly around Russia-Ukraine gas dispute", *RFE/RL*, 4 January 2009, at http://www.rferl.org/content/EU_Forced_To_Tread_Softly_On_RussiaUkrainian_Gas_Dispute/1366687.html (Accessed on the 3rd July 2013).

Gazprom does not deescalate in the face of the supply crisis as in January 2006; it escalates the dispute and establishes an embargo, stopping all supplies through Ukraine

On the 5th January in a carefully managed *mise en scène*, Prime Minister Vladimir Putin was filmed in a meeting with Alexei Miller, Gazprom's chief executive, on Russian state television. The latter reported on the general situation regarding the gas dispute with Ukraine and suggested to the Prime Minister that Gazprom starts reducing supplies according to the amount that was being "stolen" by Ukraine.¹⁷⁹ As could be expected, Putin approved the initiative. In a nutshell, this meant that if Ukraine persisted in siphoning off gas, Gazprom would eventually cease any supply through Ukraine and thus impose a de facto embargo on every European customer depending on this line of supply. Gazprom simply wanted to progressively reduce supplies equivalent to what Naftohaz had (allegedly)¹⁸⁰ been siphoning off illegally. If added on a daily basis, this would translate into what eventually happened, namely, a total freeze of supplies through Ukraine. Even if not responsible for the bilateral dispute, all consumers would suffer the consequence of Gazprom's relinquishing any responsibility and laying the blame exclusively on Naftohaz. As 80% of gas supplies sold by Gazprom to Western and Central Europe transited through Ukraine, this translated into an almost absolute embargo for those countries, especially for those depending on a 100% on Russia for their supply and which could hardly be fully compensated for by any increase through alternative routes like Belarus or Turkey. Europe was thus heading towards a real energy crisis to a much worse degree than had been the case in the short supply crisis in January 2006.

What is puzzling in this decision is that it contrasted with Gazprom's intention one day earlier. As mentioned above, on 4th January Gazprom proposed to increase supplies through Ukraine in order to make up for those volumes siphoned off by Ukraine and thus solve the problems of undersupply that were being experienced in Central Europe. Gazprom stated it had requested Naftohaz to accept an additional volume of 15mcm per day, with the latter refusing.¹⁸¹ The Ukrainian side of course, denied this had taken place at all,¹⁸² but whatever really had happened, the fact is that Gazprom then took a radically different course: instead of ensuring the energy security of all its customers (apart from Ukraine, of course) it

¹⁷⁹ Kramer, Mark: "Gazprom reduces deliveries of gas through Ukraine", *New York Times*, 6 January 2009, at http://www.nytimes.com/2009/01/06/world/europe/06ukraine.html?_r=0 (Accessed on the 3rd July 2013).

¹⁸⁰ That Naftohaz had been siphoning off gas is beyond doubt, as this itself was acknowledged in Ukraine. "Allegedly" refers to the issue of legality. As we saw before, Gazprom claimed Ukraine's actions were illegal, whereas Naftohaz claimed the contrary.

¹⁸¹ "Gazprom" govorit, chto Ukraine otkazalas' ot dopolnitel'nogo gaza dlia evropei'tsev ("Газпром" говорит, что Украина отказалась от дополнительного газа для европейцев)", *Ukrainskaia Pravda*, 5 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/5/4459733/> (Accessed on the 3rd July 2013).

¹⁸² Kramer, Mark: "Russia cuts gas, and Europe shivers", *The New York Times*, 6 January 2009, at <http://www.nytimes.com/2009/01/07/world/europe/07gazprom.html?pagewanted=all> (Accessed on the 4th July 2013).

decided to take them de facto hostage. Namely, it was using them to punish Ukraine. The contrast with Gazprom's steps as taken in the two previous disputes is absolute.

Gazprom calculated the total amount of gas extracted by Ukraine since the January 1st, which, as reported by Miller to its Prime Minister amounted to 65.3mcm. Consequently, this was the exact amount of gas it was decided to cut on 5th January. The next day a new factor added confusion as to who was to blame for the current situation. As supported by declarations from both Alexei Miller and Alexandr Medvedev, the former in a session with Prime Minister Putin¹⁸³ and the latter at a press conference with the German minister of economic affairs, Michael Gloss,¹⁸⁴ Ukraine was supposed to have completely closed certain transit gas entries, thus further depriving much of Europe of needed gas. According to Medvedev, three were the entries that Ukraine had decided to close, whereas Miller stated that Ukraine had blocked all supplies to the Balkan Region. The confusion lay in the fact that it could not be clarified whether Naftohaz's move was a consequence of Gazprom's decision to reduce the flow of gas or whether Naftohaz had unilaterally taken this measure to worsen the effect of Gazprom's latest cut-off. It could also be surmised at the time that Gazprom was simply trying to blame Naftohaz in the psychological war that was being waged, especially after having taken a decision that threatened to tarnish its reputation. However, Ukraine might also have nothing to lose in aggravating the energy crisis after Gazprom had exposed itself with a very risky move. Naftohaz's press service mentioned that three (out of four) transit gas entries to Ukraine had ceased to receive any supply, so the question remains whether the shutting down of outlets out of Ukraine was not the logical consequence from this situation rather than a conscious strategy by Ukraine.¹⁸⁵ In declarations by Valentin Zemlianskii', this was precisely the argument put forward.¹⁸⁶

As in the previous days, Gazprom again carefully planned how to respond to the European customers and appear as a partner concerned with their interests. Alexandr Medvedev reiterated Gazprom's efforts to increase supplies through alternative routes, as Yamal-Evropa (Belarus), Blue Stream (Turkey) and even gas stored in storage facilities in Europe. However, Gazprom kept reducing the

¹⁸³ "Putin: "Ukraina ukrala gaz ne u Rossii, a u evropei'skikh potrebitelei' (Путин: "Украина украла газ не у России, а у европейских потребителей")", *Ukrainskaia Pravda*, 6 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/6/4459842/> (Accessed on the 4th July 2013).

¹⁸⁴ "Gazprom" ne khochet posrednikov i ne vidit zhelaniia Ukrainy dogovarivat'sia ("Газпром" не хочет посредников и не видит желания Украины договариваться)", *Ukrainskaia Pravda*, 6 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/6/4459835/> (Accessed on the 4th July 2013).

¹⁸⁵ "Gazprom sharply reduces gas supply to Ukraine - Naftogaz", *Itar-Tass*, 6 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁸⁶ Gow, David; Milner, Mark and Harding, Luke: "Row over Russian gas chokes supply to rest of Europe", *The Guardian*, 6 January 2006, at <http://www.guardian.co.uk/world/2009/jan/06/gas-russia-ukraine-europe> (Accessed on the 4th July 2013).

flow of gas transiting through Ukraine in accordance with the new policy. On 6th January, the volume reduced had reached 92mcm.¹⁸⁷ The next day, gas flows had ceased altogether. As the day before, Gazprom and Naftohaz engaged in a new row of reproaches accusing each other of the outcome. Medvedev intervened again calling on Ukraine to open its pipelines to transit for Russian gas; according to him, Ukraine had indeed stopped accepting any flow of gas at the only entry point that still remained open the day before, Sudzha.¹⁸⁸ The Ukrainian version was the opposite, as it notified that "*at 7:44 local time gas supplies through the only operating gas measuring station Sudzha were completely stopped*".¹⁸⁹ In parallel, Naftohaz again claimed its right to use 21mcm of gas per day, not for Ukraine's consumption but as technical gas.¹⁹⁰ Gazprom's response to these exchanges seemed to be intended as a means to further blame Ukraine and win the battle of nerves (and possibly for prestige too). Kuprianov surmised the reasons for provoking the dispute lay in the fact that Ukraine wanted to preserve intermediaries in their bilateral energy relations.¹⁹¹ Attacking in such a direction, Gazprom was in fact aiming at one of the most obscure elements of their bilateral dispute, the need for intermediaries, which had been so often from the side of the Orange coalition blamed on Russian interests

Stalemate persists and the EU attempts at breaking the deadlock

In the face of the absence of not only any basis for agreement but of any hint at negotiations, only the European Union could be able to broker an agreement by way of facilitating negotiations. The EU represented most of the countries that were suffering the consequences of the dispute. However, it had assumed a neutral role, shying away from directly blaming either Russia or Ukraine. The EU preferred to consider the dispute officially as a commercial dispute and to call both actors in dispute to agree. Out of this position, both through the Commission or the Czech Republic's Presidency it established itself as a facilitator. This was relatively easier as the EU side kept a fluid dialogue with both partners while Naftohaz and Gazprom constantly forwarded messages and sent delegations to Brussels in an attempt to win the PR war that was unfolding in parallel with the energy dispute.

The potentially positive role the EU could play became manifest when a meeting in Brussels on 8th January of both delegations from Naftohaz and Gazprom was announced. No tripartite meeting between

¹⁸⁷ "Gazprom sharply reduces gas", *op. cit.*

¹⁸⁸ "Gazprom demands resumption of gas exports to Europe via Ukraine", *Itar-Tass*, 7 January 2009 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

¹⁸⁹ *Ibid.*

¹⁹⁰ "Naftogaz claims Ukraine did not use Russian transit gas", *Itar-Tass*, 7 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁹¹ "Ukraine gas problems caused by Kiev desire to keep mediators - view", *Itar-Tass*, 7 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

the EU, Gazprom and Naftohaz would eventually take place, thus belying the information originating from Oleg Dubina, who was indeed planning to make a trip to Brussels on that day and try to meet the delegation from Gazprom too.¹⁹² Ukrainian sources blamed the Russian side for canceling it, while the Russian Permanent Representative to the EU, Vladimir Chizov, simply stated no meeting had been planned at all.¹⁹³ This was understandable as positions remained unchanged. However, a phone conversation had taken place between Presidents Yushchenko and Medvedev at the Ukrainian initiative. It is known that the Russian position remained inflexible, namely, that Naftohaz should sign a new contract based on European market prices without any discounts or privileges whatsoever,¹⁹⁴ and nothing transpired from a meeting between Naftohaz and Gazprom in Moscow in the night from 7th to 8th January.¹⁹⁵ This meeting might have been the prelude for the bilateral meeting that seemed indeed to have taken place in Brussels.¹⁹⁶ Even if results were still non-existent, the prospects for the EU's neutrality playing a positive role were significant.

The EU soon assumed a more proactive role and jumped on an initiative by Gazprom and which Naftohaz was keen to accept. Gazprom had been insisting that observers be sent to all entry points to monitor the flow of gas in order to determine who was to blame for the disruptions.¹⁹⁷ In the face of Naftohaz's refusal, Gazprom moved on and proposed an international team of experts to perform the task of monitoring. In Brussels, Alexei Miller proposed that this team be composed of ten countries, including Russia. Only the presence of Gazprom in this team was a reason for Ukraine to continue rejecting the initiative.¹⁹⁸ Naftohaz's counter-initiative was a pledge to allow henceforth uninterrupted Russian gas transit on the sole condition that Gazprom provided technical gas. This time, it was

¹⁹² "Miller, Dubina to meet in Brussels Thur - Naftogaz Ukrainy", *Itar-Tass*, 7 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁹³ "EU - Gazprom-Naftogaz tripartite meet cancelled - Dubina", *Itar-Tass*, 8 January 2009 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

¹⁹⁴ "New contract needed for gas supply resumption to Ukraine - Medvedev", *Itar-Tass*, 7 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁹⁵ "Gazprom, Naftogaz chiefs hold talks in Moscow", *Itar-Tass*, 8 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

¹⁹⁶ *Ibid.* On the 9th of January *Itar-Tass* said that in fact, Miller and Dubina had arrived in Brussels on the same plane, coming thus from Moscow where they had been holding conversations and also departed together to Sochi (see: "Gazprom, Naftogaz heads may negotiate this Fri for supply resumption", *Itar-Tass*, 9 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries)).

¹⁹⁷ It was reported that the European institutions had been considering the monitoring as a solution since Monday 5th (see: Bilefsky, Dan and Kramer, Andrew E.: "Deal to end Russia's cut off of gas remains uncertain", *New York Times*, 10 January 2009, at <http://www.nytimes.com/2009/01/10/world/europe/10gazprom.html> (Accessed on the 8th July 2013), although with Gazprom having mentioned the creation of a monitoring group already, it is possible that they used Gazprom's proposal reformulated in a multilateral level.

¹⁹⁸ Jolly, David: "Effort to resolve gas crisis inches ahead", *New York Times*, 8 January 2009, at <http://www.nytimes.com/2009/01/08/world/europe/08iht-gazprom.4.19200282.html?pagewanted=all> (Accessed on the 8th July 2013).

Gazprom's turn to remain adamant and to insist on its idea of a monitoring team.¹⁹⁹ As most positions during those days, they were not auspicious. However, Brussels discrete but proactive position did pay off. On 9th January Brussels announced that an agreement had finally been reached on the issue of monitoring. That would allow a team of experts to be deployed in order to carry out monitoring so Russian supplies could be restored.²⁰⁰ Both Russian and Ukrainian monitors would have full access to the opposite side of the pipeline system, while a third team of European monitors would be present to guarantee objectivity and to avoid the risk of manipulation by any of the two parts.²⁰¹ It was confirmed that around 10 to 12 European monitors would be part of the whole team,²⁰² sent as the first group of a whole team of 22 monitors.²⁰³

This (arguably the first) positive news since the start of the dispute was followed by hints of solution for the commercial dispute that was at the core of the gas dispute. First, there was news that Miller and Dubina might continue negotiations after the meeting in Brussels. Second, Vladimir Putin's press conference on 8th January, in spite of its aggressiveness towards Ukraine,²⁰⁴ introduced a potentially promising element: Putin maintained its insistence on market prices, but he also opened the door for an increase in transit tariffs ranging from US\$3tcm/100km to US\$4tcm/100 km. Third, the Czech Prime Minister Mirek Topolánek, in a joint press conference with the Ukrainian President, suggested that any upcoming agreement be trilateral, thus also including the European Commission.²⁰⁵ This new proactive move from the part of the EU could allay mutual suspicions between Russia and Ukraine. Topolánek went as far as to make a direct contribution, suggesting a concrete pricing solution while mentioning the fact that market prices might soon become as low as US\$250tcm.²⁰⁶

¹⁹⁹ *Ibid.*

²⁰⁰ Jolly, David: "Deal struck to end gas cutoff", *New York Times*, 9 January 2009, at <http://www.nytimes.com/2009/01/09/world/europe/09gazprom.html> (Accessed on the 8th July 2013).

²⁰¹ Lobjaskas, Ahto: "EU announces breakthrough in Russia-Ukraine gas crisis", *RFE/RL*, 9 January 2009, at http://www.rferl.org/content/EU_Announces_Breakthrough_In_Gas_Crisis/1368218.html (Accessed on the 8th July 2013).

²⁰² Hardin, Luke: "Hopes of end to gas crisis as Russia and Ukraine agree to monitors", *The Guardian*, 9 January 2009, at <http://www.guardian.co.uk/business/2009/jan/09/oilandgascompanies-russia1> (Accessed on the 8th July 2013). For Putin's conference see: "Ukraine is blackmailing us – Putin", *RT*, 9 January 2009, at <http://rt.com/politics/ukraine-is-blackmailing-us-putin/> (Accessed on the 8th July 2013).

²⁰³ Traynor, Ian and Harding, Luke: "Experts from Europe monitor flow", *The Guardian*, 10 January 2009, at <http://www.guardian.co.uk/business/2009/jan/10/gazprom-russia-ukraine-eu-experts> (Accessed on the 9th July 2013).

²⁰⁴ Luke, "Putin summons journalists to tell them", *op. cit.*

²⁰⁵ "Czech PM calls for trilateral agrt between EC, Gazprom, Naftogaz Ukrainy", *Itar-Tass*, 10 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁰⁶ The Czech Prime Minister did not specify which market prices he was referring to, but assuming he meant the average European price, for which German prices are usually used as a reference, we can point to the fact that these reached US\$259tcm in Q3 2009 (Pirani, Yafimava and Stern, *op. cit.*, p. 20). This means that excluding higher transport costs for Germany, Ukraine could reasonably expect lower prices. In fact, in virtue of the agreement that was eventually reached on 19th January, base prices for Q3 2009 reached 247.5tcm for Ukraine (*Ibid.*, *Idem.*), close to German prices and thus clearly abusive.

After the Ukrainian authorities had given their oral consent to the agreement Topolanek traveled to Moscow on 10th January to secure Moscow's signature. However, there were disagreements, as Moscow complained that Ukraine rejected the team of observers and excluded any representation by Gazprom.²⁰⁷ Ukraine explained that the mission, as constituted so far (EU observers were already located in Kiev)²⁰⁸ was too cumbersome. Some analysts pointed to Ukraine's fear of seeing the EU and Gazprom representatives ganging up against Naftohaz.²⁰⁹ Then, when the Russian side duly signed the agreement,²¹⁰ obtaining Ukraine's signature proved more difficult. The Russian Foreign Ministry had to refute a Ukrainian statement claiming Russia did not accept the access of international experts to its territory,²¹¹ while Sergei Kuprianov pointed to the fact that Ukraine had not yet signed the protocol.²¹² Gazprom's spokesman complained that in spite of the documents having been supposedly signed in Kiev no copy had reached Gazprom.²¹³ Monitors, both from Naftohaz and from European companies composing the whole team were deployed already in the metering station of Sudzha on the Russian side (the others being Sokhranovka, Pisarevka, Valuiki and Platovo and from the Ukrainian side Orlovka, Tekovo, Beregov, Uzhgorod and Drozdovichi).²¹⁴ However, Gazprom made clear that no gas would flow unless Kiev finally proceeded with the signature of the protocol. When a copy was finally sent to the Russian side, it contained new conditions, which led the Russian president himself to declare on 11th January the protocol void.²¹⁵ Kuprianov explained that Ukraine had added a demand to guarantee technical gas in order to prevent disruptions occurring again.²¹⁶ Only after the President of the European

Only owing to discounts also agreed for the year 2009, could Ukraine pay by then a more acceptable price of US\$198tcm (*Ibid.*, *Idem.*). Therefore, Topolanek seemed right to point to soon to be acceptable prices for Ukraine. Unfortunately, it still took 10 more days for the dispute to be fully ended.

²⁰⁷ Bilefsky, Dan and Kramer, Andrew E.: "Deal to end Russia's cutoff of gas remains uncertain", *The New York Times*, 10 January 2009, at http://www.nytimes.com/2009/01/10/world/europe/10gazprom.html?_r=0 (Accessed on the 13th September 2013).

²⁰⁸ *Ibid.*

²⁰⁹ *Ibid.*

²¹⁰ "La pression s'accroît sur Kiev dans la crise du gaz", *Le Figaro*, 10 January 2009, at <http://www.lefigaro.fr/international/2009/01/10/01003-20090110ARTFIG00507-poutine-l-ukraine-mene-un-blocus-contre-l-europe-.php> (Accessed on the 13th September 2013).

²¹¹ "Russia refutes Ukraine statement on reluctance to admit EU experts", *Itar-Tass*, 10 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²¹² "Gazovye" kamni pretknoveniia ("Газовые" камни преткновения), *Sankt-Peterburgskie Vedomosti*, 11 January 2009 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

²¹³ "Absence of signed protocol hinders resumption of transit - Gazprom", *Itar-Tass*, 11 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²¹⁴ "Foreign observers to come to Sudzha station in a few hours", *Itar-Tass*, 11 January 2009 (Accessed on the 28th August 2011, from East View, Harvard Libraries).

²¹⁵ "Livraison de gaz : le président russe casse l'accord", *Figaro*, 11 January 2009, at <http://www.lefigaro.fr/international/2009/01/11/01003-20090111ARTFIG00028-les-livraisons-de-gaz-russe-vont-reprendre-en-europe-.php> (Accessed on the 13th September 2013).

²¹⁶ "Gazprom says Ukraine's demand for free gas for transit absurd", *Itar-Tass*, 12 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries). As for details, it transpired that Ukraine proposed to pay US\$201tcm for the needed technical gas (21mcm per day), whereas Gazprom insisted as since the beginning of the dispute, on US\$450tcm (see: Grib,

Commission himself, Manuel Barroso, convinced the Ukrainian Prime Minister herself to withdraw the addendum,²¹⁷ was the last hurdle removed. The next day the Ukrainian authorities signed again, this time the original document and the final signature by the EU Energy Commissioner, Andris Piebalgs, was made on 12th January in Brussels.²¹⁸ As the Russian and Ukrainian delegations were attending a meeting of EU energy ministers in Brussels, an informal trilateral meeting of the three parts was organized and assurances were given that gas would start flowing on 13th January 2009.²¹⁹

The monitoring agreement flounders and the dispute continues

13th January was the date for the resumption of Russian supplies through test deliveries to check feasibility for a global resumption.²²⁰ However, the long fought for protocol floundered from the very beginning. President Vladimir Putin called Manuel Barroso to inform him that in spite of Gazprom having proceeded with the resumption of supplies, these could not enter the Ukrainian Gas Transportation System as Ukraine had apparently not opened the trunk pipeline yet.²²¹ Gazprom initially wanted to ship 76.6mcm towards the hard-hit Balkan countries and Moldova, but this volume could not cross the Ukrainian border.²²²

Controversy regarding gas flows

Ukraine soon offered a explanation for this anomaly: the system had been redirected for domestic needs (eastwards from the storage facilities in Western Ukraine) and could not serve flows coming from an opposite direction (westwards);²²³ sending emergency supplies to the rest of the country involved using the transportation system left empty after Russia had cut all supplies and letting Gazprom resume gas supplies westwards would leave (at least the Easternmost part of) Ukraine freezing the same way as the Balkans. Ukraine contended that a solution could be found and put the blame on the Russian side. As Bogdan Sokolovskii´ explained, Gazprom had decided to ship its supplies through an unusual and more

Natal´ia and Gavrish, Oleg: "Ukraina broсила slova na ventil´ (Украина бросила слова на вентиль)", *Kommersant*, 12 January 2009 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

²¹⁷ "Barroso persuades Timoshenko to reckon with Russia´s view", *Itar-Tass*, 12 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²¹⁸ "Eurocommissioner signs gas monitoring deal - Gazprom CEO", *Itar-Tass*, 12 January 2009 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

²¹⁹ "Gas to reach Europe tuesday - Naftogaz Ukrainy CEO", *Itar-Tass*, 12 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²²⁰ "Gazprom to resume gas supplies Jan 13", *Itar-Tass*, 12 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²²¹ "Barroso to discuss gas transit situation with Ukrainian leaders", *Itar-Tass*, 13 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²²² *Ibid.*

²²³ *Ibid.*

complex route and which forced the closing of Eastern regions from Ukraine who relied on supplies in reverse mode.²²⁴ Sokolovskii' claimed that Gazprom had consciously avoided the traditional route of Belgorod and Rostov regions in order to make internal supply impossible.²²⁵ Besides that, Sokolovskii' also explained that the pressure of those volumes of gas offered by Gazprom was too low to fire up the system.²²⁶ Naftohaz stated that before any supply was resumed, technical aspects should be discussed beforehand between both parts in order to proceed in a correct and coordinated way.²²⁷ As a solution, Naftohaz sent a letter putting forward another route Pisarevka - Valui'ki.²²⁸

The authoritative analyst Mikhail Korchemkin supported Naftohaz's technical arguments and considered Gazprom was indeed to blame, suggesting at the same time that the Russian side was acting in bad faith. According to him, if gas was to flow to the Balkans it had to be pumped through the route proposed by Naftohaz.²²⁹ From Gazprom, Alexandr Medvedev counterattacked and said that the pipeline system being geared towards domestic consumption, all available routes were disabled for normal supply to Europe.²³⁰ Medvedev also criticized the route proposed by Naftohaz as not fit for export.²³¹ The daily *Vedomosti* supported Gazprom's version and claimed to rely on sources from Naftohaz itself to support its case.²³² Gazprom explained its preference for the outlet of Sudzha as being located at the main export pipeline in direction to Europe, whereas Valuiki could not be used because of Ukrainian domestic gas flows (the same argument Naftohaz used against Sudzha), and Pisarevka was unsuitable if gas was to be

²²⁴ Pannier, Bruce: "Old equipment, multiple routes make Ukraine gas transit difficult to guarantee", *RFE/RL*, 13 January 2009, at http://www.rferl.org/content/Old_Equipment_Multiple_Routes_Make_Ukraine_Gas_Transit_Difficult_To_Guarantee/1369610.html (Accessed on the 15th September 2013). An anonymous analyst already on the 12th January stated that the Sudzha-Orlovka route was the most complex one and would cut the flow of gas from Western Ukraine, where gas store facilities were located (see: "Gazprom" sdelal podnozhku Ukraine ("Газпром" сделал подножку Украине)", *Ukrainska Pravda*, 12 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/12/4460845/> (Accessed on the 16th September 2013).

²²⁵ Harding, Luke and Percival, Jenny: "EU still without gas after Russia and Ukraine reignite pipeline row", *The Guardian*, 13 January 2009, at <http://www.theguardian.com/world/2009/jan/13/gazprom-resumes-europe-supplies> (Accessed on the 15th September 2013).

²²⁶ Grivach, Alexei': "Gazovaia probka (Газовая пробка)", *Vremia Novostei'*, 14 January 2009 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

²²⁷ "Ukraine demands Gazprom resume supplies through all lines", *Itar-Tass*, 13 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²²⁸ "Ukraina predlagaet Rossii drugoi' marshrut (Украина предлагает России другой маршрут)", *Ukrainskaia Pravda*, 14 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/14/4461193/> (Accessed on the 16th September 2013).

²²⁹ Korchemkin, Mikhail: "Gazprom insists on using just one specific pipeline", *EEGAS*, 16 January 2009, at http://www.eegas.com/ukr_090115e.htm (Accessed on the 23rd September 2013).

²³⁰ Alexandrova, Lyudmila: "Gas war between Moscow and Kiev flares up again", *Itar-Tass*, 14 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²³¹ "Russia gas transit to Europe via Ukraine not resumed", *Itar-Tass*, 14 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²³² Mazneva, "Gazovaia probka", *op. cit.*

exported in the direction of the Balkans.²³³ *Interfax* also claimed to rely on sources from Naftohaz, who supported the feasibility of gas transit through the station of Sudzha, as demanded by Gazprom.²³⁴ *Itar-Tass* provided further details: Kuprianov stated that Gazprom had received a letter from Naftohaz where it was confirmed that transit through Sudzha was technically possible, but not possible yet pending a final political decision.²³⁵ The Head of Naftohaz soon blamed an official of the company for "rushing" and denied the information.²³⁶ However, according to the daily *Nezavisimaia Gazeta* a conversation between Dubina and Miller revealed that Naftohaz could perfectly deliver Gazprom's requests from the technical point of view, but that it needed some "conditions" from the side of Gazprom for transit to be finally resumed.²³⁷

Naftohaz insists in being provided technical gas and last attempts fail

Naftohaz in particular demanded a protocol detailing technical conditions for transit. Gazprom rejected such argument and pointed to the transit agreement from 2002 to 2013, which could perfectly cover the absence of such a protocol.²³⁸ Gazprom stated that the non-signature of annual protocols of this kind was not a real obstacle, as for example none had been signed in 2007 and no serious consequences accrued at all.²³⁹ The EU commissar of Energy, Andris Piebalgs, in a clear exception of the EU's position to date, offered its limited support to Ukraine in this latest episode. He found support in his own experts who stated that indeed, the route chosen by Gazprom was technically very complicated, if not impossible.²⁴⁰

Therefore, Gazprom submitted a new request to send a similar volume of gas (76.6mcm). However, it insisted again on the same route in the direction of the Balkans. Gazprom also added a minor volume of 22.2mcm to Slovakia through the route Sudzha-Uzhhorod.²⁴¹ As before, this request could not

²³³ "Russian gas deliveries to Europe via Ukraine remain unresumed", *Itar-Tass*, 15 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

²³⁴ "Ukraina potverdila nalichie tekhnicheskikh podachi gaza cherez Sudzhu na Balkany (Украина подтвердила наличие технических подачи газа через Суджу на Балканы)", *Interfax*, 15 January 2009, at <http://www.interfax.ru/news.asp?id=57211> (Accessed on the 23rd September 2013).

²³⁵ "Naftogaz tells Gazprom can open gas transits via Sudzha station", *Itar-Tass*, 15 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²³⁶ Grib, Natal'ia: "Gazovaia voïna priznana politicheskoi" (Газовая война признана политической), *Kommersant*, 16 January 2009 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

²³⁷ Gavshina, Oksana and Khimshiashvili, Polina: "Transit uezdnogo masshtaba (ТРАНЗИТ УЕЗДНОГО МАСШТАБА)", *Gazeta*, 16 January 2009 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

²³⁸ *Ibid.*

²³⁹ *Ibid.*

²⁴⁰ Grib, Natal'ia and Gavrish, Oleg: "Dolgie gazoprovody (Долгие газопроводы)", *Kommersant*, 15 January 2009 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

²⁴¹ "Gazprom again submits gas transit application to Naftogaz", *Itar-Tass*, 14 January 2009 (Accessed on the 27th August 2011, from East View, Harvard Libraries).

be fulfilled for the same reasons.²⁴² At this stage, after Presidents from Moldova, Slovakia and Bulgaria travelled to Moscow in search of explanations, the Vice-Prime Minister, Igor´ Sechin, publicly offered Ukraine to fulfill themselves requests from Europe from their own deposits if transit of Russian gas remained impossible,²⁴³ a variant also supported by the Slovak Prime Minister Robert Fico.²⁴⁴ Every attempt to unblock this situation was to no avail.

The last stage of the dispute and the way to its final resolution

With a temporary agreement for resumption of gas transit failing at its very beginning, the need to find a quick agreement was the only solution to put an end to the supply crisis in Europe. The focus was thus necessarily back on negotiations and both the involvement of the EU and the unsustainable situation in the rest of Europe were probably putting the necessary pressure on Ukraine and Russia to either force a compromise or to lead to the capitulation of any of them.

Maybe as a result of this general situation, a round of negotiations had been agreed for Saturday 17th in Moscow, on the invitation of the Russian President Dmitri Medvedev. EU representatives were not initially intended to attend what was expected to be a strictly bilateral meeting. However, both a Czech representative in the person of the Minister of Trade and Industry as well as the Energy Commissar Andris Piebalgs decided to be present.²⁴⁵ Given respective positions between Russia and Ukraine, with the former inflexibly insisting on the price of US\$450tcm and Ukraine sticking to prices similar to those offered at the last stage of negotiations before the dispute started, there should not have been any particular reason for optimism. As for Ukraine´s position, recent declarations by Bogdan Sokolovskii´ were quite revealing: Ukraine should pay between US\$192.6tcm and US\$218.8tcm in the first quarter, with transit tariffs of US\$2.2tcm/100km to US\$2.47tcm/100km.²⁴⁶ Price ranges close to what Gazprom was offering before the dispute: namely between US\$235tcm to US\$250tcm would be acceptable only

²⁴² "Ukraine again refuses to let Gazprom pump gas to Europe", *Itar-Tass*, 15 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁴³ "Rossiia predlozila Ukraine postavit´ gaz v Evropu iz sobstvennykh zapasov (Россия предложила Украине поставить газ в Европу из собственных запасов)", *Kommersant*, 14 January 2009, at <http://www.kommersant.ru/doc/1102603> (Accessed on the 23rd September 2013).

²⁴⁴ Kashin, Vasilii´ and Mazneva, Elena: "Nepodvizhnyi´ gaz (Неподвижный газ)", *Vedomosti*, 15 January 2009 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁴⁵ Terekhov, Andrei´: "Moskva pytaetsia organizovat´ vstrechu po gazu na vyschem urovne (МОСКВА ПЫТАЕТСЯ ОРГАНИЗОВАТЬ ВСТРЕЧУ ПО ГАЗУ НА ВЫСШЕМ УРОВНЕ)", *Nezavisimaia Gazeta*, 16 January 2009 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

²⁴⁶ "Ukraina gotova platit´ Rossii za gaz ot 192 do 218 (Украина готова платить России за газ от 192 до 218 долларов)", *Ukrainskaia Pravda*, 15 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/15/4461425/> (Accessed on the 24th September 2013).

with transit tariffs of US\$3.6tcm/100km-US\$4tcm/100km.²⁴⁷ This was in fact a less compromising position than the transit tariff Ukraine was ready to accept in December which was US\$1,8tcm/100km for gas prices of US\$235tcm.²⁴⁸

The conference was held not only with representatives from Ukraine, the EU and the Czech Republic, but with representatives too, from a group of countries, among which, some affected at different degrees by the dispute: Armenia, Belarus, Bosnia and Herzegovina, Kazakhstan, Moldova, Serbia, Turkey and Slovakia were present; leading the Ukrainian delegation was Prime Minister Yulia Timoshenko herself.²⁴⁹ The high profile of delegations and the internationalization of negotiations reasonably raised expectations about a final end of this energy crisis. As already hinted the day before, positions did not change. At the beginning of the conference, Gazprom was insisting on access for its gas through the contentious Sudzha station and had its demand consequently denied.²⁵⁰ This controversy continued along with the same sort of arguments and counterarguments: this time Ukraine justified its refusal saying that instead of the daily 100mcm that Russia wanted to start shipping, Ukrtransgaz needed at least 265mcm for the transit system to operate properly.²⁵¹

However, the well known pattern happened this time to be deceitful. Given the secrecy of negotiations it was hard to track progress (or lack thereof) and to know whether these acrimonious exchanges were mere posturing or reflected that things remained unchanged. The announcement by Sergei Kuprianov on Saturday 18th that Gazprom and Naftohaz were drafting at that moment documents for a treaty determining both gas supplies and gas transit according to an agreement reached the night before surprisingly belied any pessimism, reasonable as it may have been. This announcement bore the promise that gas flows would be soon restored, as was indeed to happen.²⁵² The core of the agreement could not be known yet, but Gazprom's spokesperson anticipated that it would determine conditions both for 2009 and 2010 and offer a discount of 20% on the price basis agreed for Ukraine in exchange for preserving transit conditions for Gazprom as in 2008.²⁵³ The discount was understood to be valid only for

²⁴⁷ *Ibid.*

²⁴⁸ Kulikov, Sergei: "Kiev pereshel dorogu Minsku (КИЕВ ПЕРЕШЕЛ ДОРОГУ МИНСКУ), *Nezavisimaia Gazeta*, 16 January 2009 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

²⁴⁹ "11 leaders, top EU officials taking part in Moscow gas conf", *Itar-Tass*, 17 January 2009 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

²⁵⁰ "Ukraine again refuses to ensure gas transit to EU - Gazprom", *Itar-Tass*, 17 January 2009 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

²⁵¹ "Ukraine needs 265 mln cbm of gas per day for transit - Naftogaz", *Itar-Tass*, 17 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁵² "Gazprom, Naftogaz drafting treaty on gas to Ukraine and for transit", *Itar-Tass*, 18 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁵³ *Ibid.*

2009, as full market prices (as in the rest of Europe) were to be established on 1st January 2010.²⁵⁴ Sources close to the negotiating team stated that the European price basis would operate retroactively from the 1st January 2009.²⁵⁵ This version was confirmed by Prime Minister Vladimir Putin after the end of talks with his Ukrainian counterpart.²⁵⁶ Did the formula "market prices" mean that Russia had won this dispute? As the exact price basis for Ukraine had not been revealed yet, this might still be part of the information war. However, if Gazprom felt confident to talk of market prices it was safe to assume that prices were close to what Russia had been insisting on since the breakdown of negotiations, namely, over US\$400tcm. *Kommersant* went as far as to mention the high figure of US\$470tcm,²⁵⁷ basing itself supposedly on earlier declarations by Mr. Kuprianov in such direction.²⁵⁸

8. 6. The 19th January 2009 Agreement

The final agreement was signed on 19th of January by both Prime Ministers, putting thus an end to the worse energy dispute to date. Its full content was disclosed to *Ukrainska Pravda* only two days later.

Market prices and higher transit tariffs and suppression of RosUkrEnergo

The agreement involved the approval of two new contracts, determining price and transit, valid for 11 years, from 2009 to 2019.²⁵⁹ The price agreed for the first trimester appeared to be US\$360tcm for Ukraine and the transit tariff only slightly rose to US\$1,9tcm/100km from US\$1,7tcm/100km in 2008. Both figures responded to the application of a 20% discount for 2009, as had been revealed by Sergei Kuprianov before. Thus, the transit tariff would rise further in 2010 and it was announced at the time that it would reach US\$2.5tcm/100km, following declarations by Aleksandr Medvedev;²⁶⁰ prices by 2010 were supposed to be full market prices, namely, Ukraine would pay according to the price basis agreed,

²⁵⁴ *Ibid.*

²⁵⁵ "Gazprom, Naftogaz to conclude direct contract", *Itar-Tass*, 18 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁵⁶ "Russia, Ukraine to switch over to European prices in gas trade", *Itar-Tass*, 18 January 2009 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

²⁵⁷ "Evrokomissiiia privetstvuet dogovorennosti po gazu (Еврокомиссия приветствует договоренности по газу)", *Kommersant*, 18 January 2009, at <http://www.kommersant.ru/news/1121190> (Accessed on the 16th October 2013).

²⁵⁸ "Gazprom, Naftogaz to sign deals opening gas transit to Europe", *Itar-Tass*, 19 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁵⁹ Not 10 years as initially assumed (see: Mazneva, Elena and Reznik, Irina: "10 let novogo rezhima (10 лет нового режима)", *Vedomosti*, 20 January 2009 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

²⁶⁰ "Tarif na transit gaza cherez Ukrainu mozhet uvelichit'sia v 2010 godu (Тариф на транзит газа через Украину может увеличиться в 2010 году)", *Kommersant*, 20 January 2009, at <http://www.kommersant.ru/doc/1105919> (Accessed on the 22nd October 2013).

although it seemed at the moment that a reduced discount of 10% would be kept.²⁶¹ US\$360tcm being a discounted price, the price basis was significantly higher. In fact, it was the same figure Gazprom had been threatening with since negotiations entered their last stage and which had become non-negotiable since the dispute started: US\$450tcm. This price resulted from taking into account the European median price from January-September 2008.²⁶² Gazprom was thus applying to Naftohaz the classical market formula of linking gas pricing to the evolution of median oil prices in the 9 previous months. In accordance with contracts Gazprom had signed with most of clients in the rest of Europe, prices would be recalculated every trimester.²⁶³

As planned in the March 2008 agreements and agreed in the memorandum of October, no intermediary would be present and RosUkrEnergo lost its privileged status as monopolist. Naftohaz would be thus tied to Gazprom for every supply related to the new agreement. It was also decided that Naftohaz would be supplied 11bcm as technological gas priced at the very advantageous price of US\$153tcm.²⁶⁴ As would be revealed soon and as explained below, Gazprom's generosity came at the expense of RosUkrEnergo, not only dumped as intermediary but now seemingly dispossessed too.²⁶⁵ This transfer would prove controversial, but now most questions were busy considering the way Gazprom managed to offer a discount to Naftohaz. Was this related to the mix of gas decided?

Puzzles regarding new energy prices and mix of Central and Russia natural gas

As the reader may remember, up to the very last negotiations the issue of pricing of Central Asian gas had been crucial. However, the reader may also remember that the issue fell into partial oblivion, not only because of the preeminence of the issue of debt claimed by Gazprom, but also because no agreement seemed to have been reached. Now that the dispute was over and prices between Gazprom and Naftohaz agreed, the issue necessarily came back to the fore. *Vedomosti* indeed thought that discounted prices

²⁶¹ Grib, Natal'ia and Gavrish, Oleg: "Posrednik isparilsia (Посредник испарился)", *Kommersant*, 21 January 2009 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁶² Mazneva, Elena and Reznik, Irina: "Poluchili po formule (Получили по формуле)", *Vedomosti*, 21 January 2009 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

²⁶³ *Ibid.* As *Rossii'skaia Gazeta* informed, this was based on the Rotterdam formula, where, based on the price oil reaches in the oil stock market of the Dutch hub, a 9 month lag is determined for calculating the gas prices (see: Zykova, Tat'iana and Zikov, Sergei: "S ogliadkoi' na neft' (С оглядкой на нефть)", *Rossii'skaia Gazeta*, 21 January 2009 (Accessed on the 22nd August 2011, from East View, Harvard Libraries).

²⁶⁴ Grib, Natal'ia: "Gaz proshelsia po territorii Ukrainy (Газ прошелся по территории Украины)", *Kommersant*, 20 January 2009, at <http://kommersant.ua/doc/1106187> (Accessed on the 22nd October 2013). It was said that such advantageous price for technical gas came in exchange for preserving the transit tariff at US\$1.7tcm/100km for 2009.

²⁶⁵ Mazneva and Reznik, "Poluchili po formule", *op. cit.*

might be the result of the presence of Central Asian gas in the final mix.²⁶⁶ In support for this assumption, some reports revealed the price that Gazprom and Central Asian producers had (quite silently, may we add) agreed in the very end of 2008. Gazprom was supposed to have agreed on a price of US\$340tcm. Accounting for transport costs, this nearly matched US\$360tcm for the first trimester.²⁶⁷

The fact is that whatever the origin of the gas to be supplied henceforth, new prices for the first semester sounded like very unwelcome news for Ukraine. US\$360tcm was much higher than US\$235tcm-US\$250tcm being discussed on the 31st of December. However, the large picture shows brighter prospects for Ukraine. As already mentioned, oil prices had been diving during 2008. This guaranteed a substantial fall of gas prices during 2009. Every time that quarterly revisions took place this trend necessarily would be reflected. The crux of the question was thus what Naftohaz would end up paying as a median price for the whole year. *Vremia Novostei* made a tentative calculation based on the current prices in East Europe and deduced that by the second quarter Ukraine might already be paying a lower price of US\$330-US\$320tcm; if the tendency persisted, then gas might be priced US\$240tcm in the third quarter.²⁶⁸ Owing to the agreed discount, what Ukraine ended up paying in the third quarter, US\$198tcm²⁶⁹ was barely higher than prices for 2008, US\$179.5tcm. However, calculations predicting that gas prices would eventually fall to only US\$150-US\$160tcm after oil prices had fallen to as little as US\$50tcm per barrel by the end of 2008,²⁷⁰ proved overly optimistic.²⁷¹

Gazprom's own calculation of the median price for European gas for the whole of 2009 was US\$280tcm and US\$224tcm for Ukraine,²⁷² close to Naftohaz's calculation of US\$235tcm-US\$250tcm.²⁷³ Naftohaz soon provided further details and offered the following prices for each of the

²⁶⁶ Mazneva, Elena and Reznik, Irina: "Dogovorilis' do \$360 (Договорились до \$360)", *Vedomosti*, 19 January 2009 (Accessed on the 20th August 2011, from East View, Harvard Libraries).

²⁶⁷ Grib, Natal'ia; Granik, Irina and Gavrish, Oleg: "Rossiia raskachala gaz (Россия раскачала газ)", *Kommersant*, 19 January 2009 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

²⁶⁸ Denisov, Andrei' and Grivach, Alexei': "Nochnoi' kontrakt (Ночной контракт)", *Vremia Novostei*, 19 January 2009 (Accessed on the 26th August 2011, from East View, Harvard Libraries). Ukraine in fact ended up paying much less than that: US\$270.95tcm in Q2 and US\$198tcm in Q3 (see: Pirani, Stern and Yafimava, *op. cit.*, p. 20). *Vremia Novostei*' calculation is more accurate though, if comparing with base prices (without discount): US\$338.68tcm in Q3 and US\$247.5tcm in Q3 (*Ibid.*, *Idem.*).

²⁶⁹ Pirani, Stern and Yafimava, *op. cit.*, p. 20.

²⁷⁰ Kutsyplo, Konstantin: "po goriuchim sledam (По горячим следам)", *Kommersant*, 19 January 2009, at <http://www.kommersant.ru/doc/1102893> (Accessed on the 17th October 2013).

²⁷¹ \$198tcm in Q3 was in fact the lowest price (9 months after oil's low point), as it rebounded already in the next quarter (Q4): US\$208.5tcm (see: Pirani, Stern and Yafimava, *op. cit.*, p. 20).

²⁷² Mazneva and Reznik, "10 let novogo rezhima", *op. cit.*

²⁷³ Grib, Natal'ia and Gavrish, Oleg: "Moskva i Kiev ustupili v roli pobeditelei' (Москва и Киев уступили в роли победителей)", *Kommersant*, 20 January 2009 (Accessed on the 23rd August 2011, from East View, Harvard Libraries). Both calculations were incorrect if considering prices as calculated in: Pirani, Stern and Yafimava, *op. cit.*, p. 20); the median price for Ukraine in 2009 was US\$259.3tcm (calculation by the author from *Ibid.*, *Idem.*).

trimesters: US\$360 for the first, as already announced, US\$270tcm for the second, US\$219tcm for the third and US\$162tcm for the fourth.²⁷⁴ Naftohaz had decided that gas would be sold to consumers according to a median price of US\$228tcm.²⁷⁵ Alla Eremenko from *Zerkalo Nedeli* talked of a second calculation according to which, prices per trimester would be as follows:²⁷⁶ US\$360tcm; US\$323.03tcm; US\$241.5tcm and US\$152.12tcm.²⁷⁷

Reception and interpretation of the new agreement

Political reactions

News of the new agreement shocked many in Ukraine: the leader of the Party of Regions, Viktor Yanukovich, declared that whatever price over US\$250tcm would lead the Ukrainian economy to a crash.²⁷⁸ Opposition from the part of Yanukovich was logical, but the Party of Regions did not necessarily represent the most acrimonious expression of opposition to the new agreements. As quite often in the past, most active against the government was the Presidential Administration. On the eve of the official announcement of the agreement, in the Presidential Administration expectations were that prices would rise to US\$200tcm with a transit tariff of US\$2tcm/100 km.²⁷⁹ Bogdan Sokolovskii', who complained that the contracts had not been agreed with the President,²⁸⁰ questioned the price basis agreed on the basis that European customers paid US\$300tcm. He thus deduced that once the discount was applied, prices should range from US\$220tcm to US\$240tcm.²⁸¹ He also complained that prices for Hungary at the current moment were US\$403tcm, lower than the US\$450tcm basis applied to Ukraine.²⁸² With Hungary's price

²⁷⁴ Grib, "Gaz proshelsia po territorii Ukrainy", *op. cit.*

²⁷⁵ *Ibid.* We were informed that this price included technical gas, whose origin is mentioned above and detailed further below. This could account for the difference between US\$259.3tcm as calculated here and the lower price of US\$228tcm, as this gas was priced only US\$153tcm.

²⁷⁶ Eremenko, Alla: "Tochka rosy (Точка росы)", *Zerkalo Nedeli*, 23 January 2009, at http://gazeta.zn.ua/POLITICS/tochka_rosy.html (Accessed on the 6th September 2014).

²⁷⁷ Prices ended up being these: US\$360tcm; US\$270.95tcm; US\$198tcm and US\$208.5tcm (Pirani, Stern and Yafimava, *op. cit.*, p. 20).

²⁷⁸ "Yanukovich schitaet, chto evropei'skaia tsena na gaz - krakh (Янукович считает, что европейская цена на газ - крах)", *Ukrainska Pravda*, 19 January 2009, at <http://www.pravda.com.ua/rus/news/2009/01/18/4462010/> (Accessed on the 16th October 2013).

²⁷⁹ Mazneva and Reznik, "Dogovorilis' do US\$360", *op. cit.* It is hardly possible that Yushchenko's entourage realistically expected such prices. It rather seems such announcements were made to put in evidence the government that would soon reveal more "disappointing" results.

²⁸⁰ "Timoshenko not agreed on Russian gas price with Yushchenko", *Itar-Tass*, 21 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁸¹ Grib, Granik and Gavrish, "Rossiia raskachala gaz", *op. cit.*

²⁸² Mazneva and Reznik, "10 let novogo rezhima", *op. cit.*

basis he calculated US\$199tcm as the median price for 2009. Globally, Sokolovskii´ considered Ukraine would lose US\$1bill as a result of the new agreements.²⁸³

Yushchenko also criticized Naftohaz for calculating a median price of US\$228tcm. The Ukrainian President doubted that prices might fall as low as US\$132tcm in the fourth quarter (and he was right) for Naftohaz´s median price to be possible.²⁸⁴ When Naftohaz announced that price, the Presidential Secretariat, this time through its First Deputy Head Olexandr Shlapak, counterattacked and proposed US\$258tcm as the most likely price.²⁸⁵ Controversy came along with policy proposals that threatened the agreement: for example, when the transit tariff for 2009 was known, Yushchenko simply proposed that the Head of Naftohaz should unilaterally raise it (something which Timoshenko had tried herself to no avail), incensed as he was that Gazprom kept the same transit tariff as in the previous year.²⁸⁶ However, it soon was acknowledged that the signature of the latest contracts was valid,²⁸⁷ and the President´s entourage simply started calling the government to renegotiate the agreements in summer.²⁸⁸ Therefore, the 19th of January agreement was mostly used as a weapon to launch personal attacks within the realm of internal politics of Ukraine. This, the Head of the Presidential Secretariat, Viktor Baloga, did when he assumed corruption was at the center of Putin and Timoshenko´s agreement and that on the basis that no specific price had been immediately provided. He suspected that secrecy guaranteed that opaque kick-backs remained unknown.²⁸⁹

Analysts´ assessments of the agreement

But this agreement did not just elicit opposition among the ranks of the Ukrainian political class. Analysts and specialists on energy issues also joined the fray. This agreement was definitely much clearer than the mindboggling one of January 2006. However, some of its provisions remained controversial. Among these the price basis that Gazprom had chosen for Naftohaz was the main one. The analyst Mikhail Zapozin considered the price basis of US\$450tcm for Ukraine not correct for the simple reason that prices

²⁸³ "Ukraine to lose \$1 bln as result of Naftogaz - Gazprom agts - official", *Itar-Tass*, 21 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁸⁴ Mazneva and Reznik, "Poluchili po formule", *op. cit.*

²⁸⁵ "Gas price for Ukraine in 2009 to be about US\$258 - Ukr official", *Itar-Tass*, 23 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries). Credit must be given to Yushchenko´s entourage this time, as this is almost exactly the real median price, US\$259.3tcm (see fn. 273).

²⁸⁶ Grib and Gavrish, "Moskva i Kiev ustupili v roli", *op. cit.*

²⁸⁷ "Gazprom - Naftogaz contracts valid - Ukr official", *Itar-Tass*, 23 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁸⁸ Reznik, Irina: "11 let zakonchatsia letom (11 лет закончатся летом)", *Kommersant*, 26 January 2009 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

²⁸⁹ "PM was to protect Ukrainian interests in Moscow - press secretariat", *Itar-Tass*, 20 January 2009 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

for the current quarter in Western Europe were US\$400tcm.²⁹⁰ This was clearly unfair for Ukraine due to the obvious differences of distance.²⁹¹ Another analyst, Dmitrii' Aleksandrov from "Financial Bridge" calculated that the median East European price for the first quarter of 2009 would amount to a little more than US\$400tcm, possibly US\$418, which is a price that had been mentioned in the course of negotiations.²⁹² In a similar vein was Denis Borisov from the Financial House "Solid", who stated that the median price of European gas was lower than the US\$450tcm agreed in the contract as a basis and hovered between US\$430tcm and US\$440tcm.²⁹³ If comparing with spot prices as Mikhail Korchemkin did, the difference was even more unfavorable for Ukraine: he pointed to prices of US\$350tcm paid in Belgium, Germany and Holland in the first half of January and poised to drop further.²⁹⁴ Since then, Ukraine has not been able to renegotiate this beyond being granted further discounts.²⁹⁵

Epilogue: solving the remaining debt, spoils from RosUkrEnergo and further political disagreements

In addition to the pricing and transit agreements, Naftohaz's debt still remained to be solved. Gazprom calculated the debt as US\$614mill,²⁹⁶ corresponding to debt inherited from December in addition to fines. Naftohaz rejected these, so disagreements persisted.²⁹⁷ However, on 20th January, the day after the dispute had been solved and when normal supplies had been restored, Gazprom's Deputy CEO Alexandr

²⁹⁰ These figures, as presented in the article of *Nezavisimaia Gazeta* (see ft. below), are contradictory. We would surmise that US\$450tcm was the maximum price reached in Eastern Europe, which means prices were probably even lower at the moment of writing than US\$400 in Western Europe, with the latter price being probably for the last quarter of 2008.

²⁹¹ Kulikov, Sergei': "To li mir, to li peremirie (То ли мир, то ли перемирие)", *Nezavisimaia Gazeta*, 19 January 2009 (Accessed on the 26th August 2011, from East View, Harvard Libraries).

²⁹² *Ibid.*

²⁹³ Mordiusenko, Ol'ga and Gavrish, Oleg: "'Gazprom' ne zhduť na Ukraїne ('Газпром' не ждут на Украине)", *Kommersant*, 23 January 2009 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

²⁹⁴ Reznik, "11 let zakonchatsia letom", *op. cit.*

²⁹⁵ A first discount came in April 2010, with the so-called "Kharkov Agreements", where Ukraine was offered a discount of 30% (via custom tax exemption for Gazprom and in exchange for the extension of the leasing contract for Russia's Black Sea Fleet stationing at the Crimean base of Sebastopol) and a short-lived slashing of natural gas prices by a third (bringing then from US\$385tcm to US\$268.5tcm) was granted in December 2013, in the context of the competition between Russia and the EU for Ukraine's political orientation (President Yanukovich did not sign the Association Agreement offered by the EU in the context of the Eastern Partnership) and lasted only during the first quarter of 2014. The triumph of the Euromaidan and the ousting of Yanukovich led Russia to withdraw it. At the time of writing and after lengthy negotiations and a six-month long gas cut-off from June to December 2014, Russia maintains the 30% discount from 2010, in spite of Crimea's having been annexed by the Russian Federation in March 2014 (An account of the Peninsula's occupation can be found in: Boltenkov, Dmitry: "Russia Again: The Military Operation for Crimea", in Howard, Colby and Pukhov, Ruslan (2014): *Brothers armed: military aspects of the crisis in Ukraine*, East View Press, CAST, Moscow, pp. 157-184.

²⁹⁶ Denisov and Grivach, "Nochnoi' kontrakt", *op. cit.*

²⁹⁷ Aslund, Anders: "Prodavtsy sebja tak ne vedut s pokupatelem (Продавцы себя так не ведут с покупателем)", *Novue Vremia*, 19 January 2009 (Accessed on the 18th August 2011, from East View, Harvard Libraries).

Medvedev simply said that all debt problems had been settled.²⁹⁸ The unknown part was what exactly had been agreed.

As for RosUkrEnergo, the controversial trader and the main loser in this dispute, it saw Naftohaz confiscate all its gas located in the storage facilities of Ukraine. The volume in question, 11bcm had been contracted for companies in Central Europe with whom supply contracts were signed. However, Naftohaz declared these volumes of gas had been transferred to them and would be spent as technical gas. What type of transaction was carried out for this transfer? Was it really meant as technical gas? The daily *Kommersant* had mentioned in the course of the dispute that 6.5bcm was the amount Naftohaz needed for technical needs for the whole year.²⁹⁹ This belies the official version provided by Naftohaz, at least partially. As for the transaction, confusion reigned at the beginning. Gazprom had provided the explanation that RosUkrEnergo's gas would be "returned" to Naftohaz in payment of transit tariff.³⁰⁰ This raised *Vedomosti's* perplexity as to Gazprom's right to transfer gas to which it could only claim half (Gazprom owned 50% of RosUkrEnergo).³⁰¹

Then *Ukrainska Pravda* acquired a copy of a directive from the Ukrainian government where the following version was offered: it confirmed Gazprom sold the gas to Naftohaz in payment of the transit tariff in order to be used as technical gas.³⁰² The directive, a reflection of a parallel agreement reached on 19th January, instructed Naftohaz to acquire from Gazprom the right to have available up to 10.3bcm of gas belonging to RosUkrEnergo, paid by the Russian monopoly as an advance of transit tariffs.³⁰³ It could be deduced from this complex transaction that the price paid by Naftohaz was US\$154.6bcm. This was only slightly more than US\$153.9bcm, which, as announced by Timoshenko, Naftohaz would pay for the technical gas.³⁰⁴ *Vedomosti* provided further details which added more complexity to the transaction: according to the Russian newspaper, rights to a total debt of US\$1.7mill owed to Gazprom by RosUkrEnergo³⁰⁵ were transferred to Naftohaz. Naftohaz in fact paid Gazprom for the right to claim this

²⁹⁸ "Gazprom, Naftogaz settle all debt issues", *Itar-Tass*, 20 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries).

²⁹⁹ Grib and Gavrish, "Posrednik isparilsia", *op. cit.*

³⁰⁰ Osetinskaia, Elizaveta: "Kompaniia nedeli: Rosukrenergo (Компания недели: Rosukrenergo)", *Vedomosti*, 22 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries).

³⁰¹ *Ibid.*

³⁰² Chivokunia, Viktor: "Gazovye direktivy. Radi unichtozheniia Firtasha Timoshenko narushila zakon? (Газовые директивы. Ради уничтожения Фирташа Тимошенко нарушила закон?)", *Ukrainskaia Pravda*, 21 January 2009, at <http://www.pravda.com.ua/rus/articles/2009/01/21/4462523/> (Accessed on the 23rd October 2013).

³⁰³ *Ibid.*

³⁰⁴ *Ibid.*

³⁰⁵ The last news before negotiations were terminated in the final hours of 2008, was that US\$1,5 mill had been transferred from Naftohaz to RosUkrEnergo, with still around US\$600mill remaining (and which Alexei Miller stated to be solved on the 20th January 2009). This volume closely matches the US\$1,7mill the two companies were talking about now. It could be

debt through an advance payment by the Russian monopoly of transit tariffs. RosUkrEnergo now owed Naftohaz and paid through its gas reserves.³⁰⁶ While both Gazprom's and Naftohaz's version differed in other details,³⁰⁷ the main problem in the whole agreement was the fact that it could hardly be justified for either Gazprom or Naftohaz to freely use RosUkrEnergo's assets without having agreed with the trader before.³⁰⁸ The lack of legal basis for this fraudulent transaction was exposed when in 2010 the Stockholm Arbitrage Court gave reason to RosUkrEnergo and forced Naftohaz to return all the gas improperly obtained from Gazprom.³⁰⁹

Once the gas transfer to Naftohaz was approved,³¹⁰ it still remained to know what would be the exact use of the gas acquired by Naftohaz. Since Timoshenko confirmed the previous figure of 6.5bcm of gas required for technical needs,³¹¹ that yielded 4.5bcm of free gas. She stated that this gas would be used for internal consumption and thus lessen the dependence on Russia in a moment of very high prices.³¹² The transfer in any case posed a serious problem for consumers in Poland and Hungary, where RosUkrEnergo had signed supply contracts. In Poland for example, the state company PGNiG had

surmised that the final payment from RosUkrEnergo had not taken place yet and instead of claiming a monetary transfer, Gazprom now claimed to be paid in kind (gas). Calculating a favorable price of US\$154.9tcm would enable Gazprom to acquire all reserves of RosUkrEnergo and thus perform the final transaction to Naftohaz. This explanation would match Naftohaz's version (see: fn. 307).

³⁰⁶ Mazneva, Elena and Reznik, Irina: "Posledniaia usluga posrednika (Последняя услуга посредника)", *Vedomosti*, 22 January 2009 (Accessed on the 17th August 2011, from East View, Harvard Libraries). To the reader, the paradox should be evident: RosUkrEnergo ended up being indebted to Naftohaz, the company from which original debts accrued.

³⁰⁷ *Ibid.* According to the Russian version, Naftohaz should negotiate with RosUkrEnergo to solve the debt it still had with the latter, whereas the Ukrainian version simply stated that once Gazprom had transferred RosUkrEnergo's debt to Naftohaz, the latter could claim the equivalent in gas to RosUkrEnergo.

³⁰⁸ *Ibid.*

³⁰⁹ See: Ivzhenko, Tat'iana: "Akhmetov protiv Ianukovicha (Ахметов против Януковича)", *Nezavisimaia Gazeta*, 7 July 2011, at http://www.ng.ru/cis/2010-07-07/6_ahmetov.html (Accessed on the 23rd October 2013). As the Head of the Ukrainian Customs, Valerii' Khoroshkovskii' stated, the lack of the signature of Mr. Firtash meant that this transaction could not be considered legal (see: Grib, Natal'ia and Gavrish, Oleg: "Pol'she primorozili gaz (Польше приморозили газ)", *Kommersant*, 28 January 2009 (Accessed on the 19th August 2011, from East View, Harvard Libraries). This by the way, cost him his post: "Ukrainian govt sacks customs chief for stance in gas crisis", *Itar-Tass*, 28 January 2009 (Accessed on the 29th August 2011, from East View, Harvard Libraries), as he was suspected to be linked to Firtash own interests (Ivzhenko, Tat'iana: V Ukraine nachalas' kadrovaia revoliutsiia (В УКРАИНЕ НАЧАЛАСЬ КАДРОВАЯ РЕВОЛЮЦИЯ), *Nezavisimaia Gazeta*, 30 January 2009 (Accessed on the 26th August 2011, from East View, Harvard Libraries). At the same time, a complex game was suspected between Gazprom and the Polish PGNiG: Gazprom expected the latter to make some concessions regarding the management of the Yamal-Europe (Europolgaz company), so it may be surmised that Gazprom would more easily make up for the gap left by RosUkrEnergo if these concessions were met (see: Grib and Gavrish, "Pol'she primorozili gaz", *op. cit.*).

³¹⁰ "Ukraine's customs clears gas in underground storage units - PM", *Itar-Tass*, 1 February 2009 (Accessed on the 30th August 2011, from East View, Harvard Libraries).

³¹¹ Samdova, Evlaliia: "'Dochku' 'Gazproma' otodvigaiut ot Ukrainiskikh potrebitel'ei' («Дочку» «Газпрома» отодвигают от украинских потребителей)", *Novaia Gazeta*, 23 January 2009 (Accessed on the 18th August 2011, from East View, Harvard Libraries). This figure came close to similar volumes needed in previous years: 7.6bcm were used for 2003 and 2004, 7.4bcm for 2005 and 8.1bcm for 2006 (Pirani, Simon: "Ukraine's energy sector", Oxford Institute for Energy Studies (June 2007), at <http://www.oxfordenergy.org/pdfs/NG21.pdf>, p. 28, t. 4.1. "Ukraine's gas balance, 2003–2006 (bcm)).

³¹² Samdova, "'Dochku' 'Gazproma' otodvigaiut", *op. cit.*

contracted with RosUkrEnergo 2.5bcm of gas every year for the period of 2006-2009.³¹³ Soon the company announced it was not receiving needed supplies as contracted, with only half of expected supplies from RosUkrEnergo flowing.³¹⁴

As an epilogue to the dispute, we may mention that controversies, both within the Ukrainian political class and between Russia and Ukraine, were resurfacing. In spite of having (apparently) accepted the agreement, The Presidential Secretariat was soon advocating to contest it on the ground that Dubina (who was ailing at the hospital undergoing heart surgery) had signed the agreements under undue pressure.³¹⁵ Timoshenko declared she planned to obtain additional discounts for 2010-11,³¹⁶ and maintained her fierce opposition to any possibility of establishing a transport consortium with Gazprom. Besides that, adding controversy to the point of the contracts signed some days ago, she rejected the presence of Gazprom Sbyt in Ukraine, to which 25% of the imported gas sold in the internal market would be reserved,³¹⁷ a share similar to that agreed in the midst of the March 2008 agreements.³¹⁸ As was already stated in the previous chapter, at the end only 3bcm were sold,³¹⁹ less than 10% of the gas import market and slightly less than 5% of the whole gas market.³²⁰ Among the chorus of critics of the recent agreement, President Viktor Iushchenko did not relent in his criticism, even if this time he conceded that the agreement had to be accepted, but revised in the summer.³²¹ Either efforts from the part of Timoshenko to revise the agreements or attacks directed by her opponents, were in fact to be read as a factor of internal infighting. The Russian factor faded into the background and became rather a tool for this internal instability that had characterized the orange coalition from the very beginning.

³¹³ Grivach, Alexei': "Potesnit' "Gazprom" (Потеснить "Газпром")", *Vremia Novostei*', 24 January 2009 (Accessed on the 24th August 2011, from East View, Harvard Libraries).

³¹⁴ "Rssn - Swiss JV fails to supply needed quantities of nat gas to Poland", *Itar-Tass*, 26 January 2009 (Accessed on the 31st August 2011, from East View, Harvard Libraries). See also: Grib and Gavrish, Oleg, "Pol'she primorozili gaz", *op. cit.*

³¹⁵ "Ukraine pres secretariat believes gas agreement can be contested", *Itar-Tass*, 26 January 2009 (Accessed on the 30th August 2011, from East View, Harvard Libraries); this was contested by Oleg Dubina himself, see: "Oleg Dubina: "Naftogaz" podpisuyval soglasheniia ne pod davleniem (Олег Дубина: "Нафтогаз" подписывал соглашения не под давлением)", *Vremia Novostei* ', 29 January 2009 (Accessed on the 17th August 2011, from East View, Harvard Libraries).

³¹⁶ Mordiusenko and Gavrish, "'Gazprom" ne zhdut na Ukraine", *op. cit.*

³¹⁷ *Ibid.*

³¹⁸ Samdova, "'Dochku" "Gazproma" otodvigaiut", *op. cit.*

³¹⁹ Mostovaia, "Kompromiss. I zhizn posle nego", *op. cit.*

³²⁰ From 69.9bcm of total consumption in 2008 (see: "Natural Gas and Ukraine's Energy Future", IHS CERA, Ministry of Energy and Coal Industry of Ukraine (February 2012), at <http://s05.static-shell.com/content/dam/shell-new/local/country/zaf/downloads/pdf/research-reports/Ukraine-Policy-Dialogue-report.pdf>, p. 10 (Accessed on the 23rd October 2013).

³²¹ Barber, Toni: "'Eto plokhaya sdelka", - Viktor Iushchenko, prezident Ukrainy («Это плохая сделка», - Виктор Ющенко, президент Украины)", *Vedomosti*, 28 January 2009 (Accessed on the 23rd August 2011, from East View, Harvard Libraries).

8. 7. Preliminary Conclusions

The dispute of January 2009 stands in stark contrast with both its predecessors. It may be lumped together with January 2006 because of the common feature of having led to an energy supply crisis. However, whereas the energy supply crisis in January 2006 was very short, the long-drawn effects of the crisis in January 2009 were brutal. The decision taken by Russia to escalate to a new stage, imposing an energy embargo for all supplies is probably the single element that sets the contrast to January 2006 and March 2008. In parallel with the difference between this dispute and its two predecessors, the agreement that was reached in 19th January 2009, seems to leave little space to contradictory interpretations and can easily be termed as a Russian victory, with RosUkrEnergo removed from the stage of Russo-Ukrainian energy relations, the linkage between Central Asian supplies to Ukraine suppressed and with Ukraine accepting market prices for once.

The panorama in the energy market was suffering significant changes during the period going from March 2008, when the former dispute took place and January 2009. As we had the chance to see, new price increases were being demanded from Central Asian, with all producers, Kazakhstan, Uzbekistan and mainly Turkmenistan demanding that market prices be paid. This represented new renegotiations ahead and the fact that Ukraine would eventually have to accept these new prices, something which entailed in itself the usual danger of disagreements, even if talks in 2007 and 2008 were relatively harmonious. However, the main problem in the context was that oil prices were diving, driving natural gas prices in Europe downwards and along with them, Gazprom's profits. This coincided with a new debt dispute in late 2008. This dispute was not intrinsically worse than others that Gazprom had had to face earlier, but the financial situation and the fact that a debt issue had already led to a dispute in March 2008 might have exacerbated the situation and the importance for Gazprom to recover that debt, establishing a strong linkage between debt resolution and pricing negotiations. Doubts regarding Gazprom's agreements with Turkmenistan are also candidates that could account for the level of tensions that was reached.

Once disagreements led to a new cut-off of supplies to Ukraine, the sequence of events started exactly as in January 2006, including disagreements regarding technical gas, whose consumption led to the first stage of a new energy crisis in those countries most dependent on Gazprom's natural gas. With the first step having been taken from the Russian side in a new process of escalation, we may consider that as three years before, Ukraine decided to escalate siphoning gas off; if it seems that this time the volumes extracted matched technical needs, as opposed to what happened in January 2006, the difference

this time was that Gazprom did not backtrack to deescalate; it further escalated imposing a total gas embargo: not only gas supplies matching Ukrainian consumption were cut, but also the rest of natural gas exported through Ukraine for the rest of consumers. As seen above, Gazprom's argument was that the embargo was needed to avoid gas being siphoned off by Naftohaz. This situation was maintained until a final agreement was reached on 19th January 2009.

As opposed to the agreements reached in January 2006 and March 2008, the agreement in January 2009 seems to leave less space for interpretation, with most assessments at the time considering that Gazprom had managed to win the dispute. Although, as with the two previous disputes, our assessment will be taken up and completed in chapter 9, we may advance here that indeed, Gazprom seems having been the clear winner in this dispute, as Ukraine would henceforth have to purchase Gazprom's natural gas at market prices, with a linkage to oil prices and without the intermediation of RosUkrEnergo, so henceforth Gazprom would be fully free to dispose of Central Asian natural gas.

What accounts for the Russian attitude in the face of an energy dispute this time? This sudden change in Gazprom's management of an escalation process, going as far as to risk its reputation for the sake of winning the dispute, may be matched to what prospect theory would predict for risk-assuming actors. Indeed, this time, the Russian side did not deescalate when either the energy dispute translated into an energy crisis affecting other European countries or when the danger of this eventually happening loomed in the horizon; on the contrary, Gazprom escalated consciously knowing that its decision were not only provoking that energy crisis, but worsening it to a degree not seen to date. If Gazprom considered risks in reputational costs involved in this move, as uncertainty necessarily remained as to how long this dispute would last and in what measure reputational costs would accumulate, it was behaving in a strongly risk-taking attitude. As we have seen, and as will be further analysed in chapter 11, the context represents a strong candidate for worsened status-quo, so Russia could be easily presented as a risk-taking actor bent on preventing losses.

Chapter 9: Assessing the outcome in the three energy disputes

9. 1. Introduction

The chapters dealing with the three energy disputes analyzed in this research provided the reader with valuable information on what were the stakes involved and how diverse factors would accumulate and eventually provoke energy disputes leading to gas cut-offs as in January 2006 and January 2009. In this respect, a conscious effort has been made to provide as many details as possible in order that the reader can understand the elements necessary to know how the path towards an energy dispute is laid. Many of the events that are narrated do not necessarily have a direct link to the disputes. This is the case for example with the dispute regarding stored gas in July 2005. However, events such as this should have had a valuable didactic dimension for the reader, as they introduce elements that are consubstantial to the energy relations between Russia and Ukraine. In any case, issues revolving around debt and pricing of gas are manifestly at the core of the disputes and may easily appear as necessary, even if not necessarily sufficient, factors to understand how disputes happen. The virtue of the empirical data presented in the three chapters before, is thus obvious.

In this respect, these three chapters provide something more than mere raw information. They also answer one vital question: who won the disputes. This chapter deals with this question. As already mentioned above at the end of each of the three former chapters, the answer to this question opens the ground to considering the question regarding Russia's risk-attitude and the degree of risk, to which the final chapter is devoted. The importance of the first question is thus manifest when it comes to considering the patterns of escalation: if energy disputes escalated to a different degree, this could easily be due to Ukraine's degree of resistance. We could hypothesize that Ukraine yielded in March 2008 simply with a partial cut-off, yielded in January 2006 with a total cut-off, whereas a total embargo was needed in January 2009 to break its resistance. If the answer is negative, then Russia should be the focus of our attention, justifying our further discussion regarding Russia's risk-attitude and changes in the risk factor. The analyses we drew in each chapter clarified that this was indeed not the case, and that the different patterns of escalation clearly lay in Russian decisions in each dispute. This chapter therefore sums up the analyses made at the end of each of chapters 6, 7 and 8.

9. 2. Dispute of January 2006

As seen in the thorough analysis of the 4th January 2006 agreement in chapter 6, which put an end to the dispute, many of the provisions of the agreement were controversial and were not fully clarified. Besides this, much did not unfold as foreseen. Our assessment was that the agreement was at best a compromise and that it could not be seen as a victory from the side of Gazprom, even if it did not represent a victory for Ukraine either. Below comes a summing-up and expansion of our analysis as made earlier.

New Pricing System

The first controversy concerned the price Ukraine would pay for 2006 and the price Russia would sell its natural gas; in theory, the latter should match the former. However, this was not exactly the case: Ukraine would buy natural gas for US\$95tcm, whereas Russia would sell its natural gas at US\$230tcm. The reason why this mismatch occurred was because the price for Ukraine was in fact the median price of all gas supplied to the country. As we had the occasion to see in chapter 6 Ukraine consumed both Russian and Turkmen natural gas. The reason for lumping all natural gas supplied to Ukraine into a sole category was that henceforth, sales of all natural gas would be centralized in one single supplier, the intermediary company RosUkrEnergo, to which we come back below. Even if this was justified, it was nevertheless confusing. As far as Russian gain was concerned, instead of a median price of all gas supplied to Ukraine, the reasonable benchmark to determine whether Russia won the dispute, at least in economic terms, was the price agreed for Gazprom's gas. In this respect, Gazprom's victory was apparently clear, as US\$230tcm was the price Gazprom had been insisting on, after its first offer of US\$160 had been rejected. If we could add to that the increased role of RosUkrEnergo and the creation of the new company UkrGazEnergo, assuming their role was beneficial for Gazprom, then its victory was absolute. However, a further analysis would show that there was more to this than met the eye.

New Supplies Balance

The key to determine the economic gains for Gazprom lay in the new balance of natural gas that Ukraine would be supplied with. The agreement foresaw that instead of 23bcm of natural gas, as Gazprom had been supplying in 2005, the volume would be reduced to 17bcm. Gazprom would make less money in Ukraine, but if freed volumes could henceforth be traded in Europe, where market prices prevailed, then the trade-off was beneficial. The problem for Gazprom lay in the volumes of natural gas that would make up for reduced supplies from Gazprom. Ukraine would import more natural gas from Central Asia. The exact figures from the agreement, as leaked, were: 41bcm from Turkmenistan and as much as 7bcm from

Uzbekistan and 8bcm from Kazakhstan. The problem lay in the fact that more Central Asian gas for Ukraine meant less Central Asian gas for Russia, as Gazprom relied on Central Asian supplies to make up for insufficient production. Therefore, gains from freed Russian natural gas could happen to be either nullified or at least limited. Mikhail Korchemkin's assessment from *East European Gas Analysis*, on which we mostly relied as the most complete attempt to date to calculate Gazprom's gain, in fact interpreted that Gazprom would lose outright.

According to Korchemkin's calculation, Gazprom would end up losing between US\$945tcm and US\$741tcm per year. Oddly enough, the analysis assumed no natural gas from Gazprom would be consumed by Ukraine at all. However soon after the agreement had been signed, doubts surfaced indeed, as to whether any Russian natural gas at all would be sold to Ukraine, which would confirm Korchemkin's analysis. Data from *Vedomosti*,¹ as well as Simon Pirani's report on Ukraine's energy sector from 2007,² and his chapter on Ukraine from the book "Russia and CIS markets and their impact on Europe", pointed to this. For 2006, all three sources agreed on a volume of Russian gas supplied to Ukraine significantly lower than 17bcm: 9.1bcm. The fact is that even this was doubtful. Russian sources, months after the agreement had been signed, would claim that in fact no Russian gas at all had been supplied to Ukraine. Our own calculation showed that even this reduced volume of Russian gas would have increased prices for Ukraine beyond US\$95, which reinforces the assumption that no Russian gas was consumed. In fact Simon Pirani himself assumed that this figure, at least in part probably represented Russian gas, only in physical but not financial terms. As for 2007, Pirani shows that 4.5bcm of Russian gas were imported, even if none of it is referred to in *Vedomosti*. There is a high probability that this may be, again, gas only in physical terms. Otherwise, this represented very low volumes, so Russian gas was marginal. In general terms, Gazprom saw any potential gains nullified by the new redistribution of volumes and probably lost outright in strictly financial terms.

Gazprom's "Political" Benefits

However, as for the interpretation of Gazprom's gains in financial terms, losses did not necessarily mean that the agreement was a defeat for Russia. Political elements should also be taken into account. It should not be forgotten that Gazprom owned 50% of RosUkrEnergo and that there were probably close interests between Gazprom and the owners of the other half. As was soon revealed, Dmitro Firtash and Ivan Fursin

¹ Reznik, Irina: "Analitika: Iamalorossii'skaia trgovlia (Аналитика: Ямалороссийская торговля)", *Vedomosti*, 1 April 2008 (Accessed on the 19th August 2011, from East View, Harvard Libraries).

² Pirani, Simon: "Ukraine's gas sector", *Oxford Institute for Energy Studies* (June 2007), Table 4.1., p. 28, at <http://www.oxfordenergy.org/pdfs/NG21.pdf>.

controlled that other half. As was explained, RosUkrEnergo had already entered the natural gas business in Ukraine in 2005, when the Minister of Energy, Iurii´ Boi´ko, under Prime Minister Viktor Yanukovich, mediated. Besides this, Firtash was behind the former experiment as an intermediary, EuralTransGas, after the suppression of Itera, in 2003. Suspicions regarding RosUkrEnergo´s alliance with Gazprom were fully justified. Besides this, it was soon revealed that in 2005 already, when RosUkrEnergo was only involved in Turkmen gas, Gazprom had sold in Europe around 10bcm of natural gas through the intermediary, in what represented a clear intention to divert profits for the benefit of this obscure company. RosUkrEnergo would soon start acquiring participations in the local companies, OblHazy, so the company could be seen either as a corrupt devise for the benefit of Gazprom´s allies or better, a vehicle to penetrate Ukraine´s market and open the door to Gazprom.

Besides this, the creation of UkrGazEnergo, the new joint venture between Naftohaz and RosUkrEnergo in the internal market of Ukraine, and which was to assume the most lucrative part of its market (even if it would not mean huge financial benefits for Gazprom), could be seen the same way as RosUkrEnergo, namely, as part of Gazprom´s strategy of penetration into the Ukrainian market. However, besides the direct interest Gazprom may have had in the company, the creation of UkrGazEnergo represented a heavy blow to Naftohaz, as the former would concentrate its business in the lucrative industrial sector, where prices were not regulated. In addition, Naftohaz was henceforth forbidden to re-export Russian gas in Central Europe, a role exclusively reserved now to RosUkrEnergo, in coordination with Gazprom. Thus, along with the positive interest of Gazprom in penetrating the Ukrainian market, another possibility was that Gazprom sought the financial bankruptcy of Naftohaz as an indirect way for the takeover of the Ukrainian GTS.

RosUkrEnergo and Gazprom

Our analysis cast doubts on the value RosUkrEnergo had for Gazprom. In the first place, it must be borne in mind that RosUkrEnergo had been favored as an intermediary in substitution of EuralTransGas, during Kuchma´s administration. As the agreements subscribed in August 2004 foresaw, Ukraine was to import eventually only Turkmen gas, indeed and RosUkrEnergo was to participate in the development of upstream projects in Central Asia. The ultimate goal of Gazprom was to establish a consortium for the management of the Ukrainian GTS, even if Kuchma´s administration resisted this. It seems plausible that Gazprom favored financially a company that was to play an important role in this scheme. The rebalancing of gas supplies as a result of the 4th January agreement fulfilled this, which as we analyzed above, should have borne economic losses for Gazprom. However, favoring Ukraine under Kuchma is

definitely not the same as favoring Ukraine under the loathed Yushchenko. One has therefore to be cautious when linking the favors made to RosUkrEnergo already in 2005 to the even more advantageous position it started enjoying from 2006. More elements complicate the whole picture: the same way Firtash was on good terms with the previous administration, the truth is that it maintained very good relations with Yushchenko's entourage too. Firtash skillfully moved to ingratiate himself with the new authorities and his move seems to have worked: Yushchenko protected RosUkrEnergo against his Prime Minister Yulia Timoshenko, who tried to uncover the obscure dealings of the trading company; Timoshenko, by the way, was sacked in September 2005. The interests of Yushchenko himself to favor RosUkrEnergo should not be underestimated.

From another side, Russia's relations towards intermediaries are interesting when the progression from the establishment of Itera to the elimination of intermediaries in the agreement of 19th January 2009 is considered. Itera, which brought prejudice to Gazprom as a company, but responded to the corrupt schemes of its leadership, was removed in 2003. In its stead, the obscure EuralTransGaz, where Firtash already played a leading role, was established. The obscurity of its management revealed, both Ukraine and Russia decided in 2004 to bring to the fore the no less obscure RosUkrEnergo, whose importance lies at the very center of our research. However, RosUkrEnergo did represent a certain modicum of rationalization: instead of the entirely private interests involved in EuralTransGaz, RosUkrEnergo, as mentioned above, was owned 50% by Gazprom and 50% by Ukrainian private interests in the persons of Dmitry Firtash and Ivan Fursin. The fact is that from the side of Russia, there had been an attempt at the time to establish a joint venture between Gazprom and Naftohaz instead. The Russian interest for sidelining private interests seems to be reinforced by the fact that in 2008, as analyzed further below, there seemed to be no objections to agreeing with the manifestly anti-Russian Yulia Timoshenko the eventual elimination of intermediaries. RosUkrEnergo's exclusion from Russo-Ukrainian energy relations was effected in January 2009, when Gazprom clearly imposed itself after a bitter dispute. This pattern arguably reinforces the suspicion that Gazprom accepted an increased role for RosUkrEnergo as a compromise to solve a dispute that soon escaped from its control.

The Process of Escalation in January 2006

One last clue to refute the intuitive narrative of RosUkrEnergo's being an active vehicle for Gazprom and part of a strategy to maximize gains out of the gas dispute in 2006 is the pattern of escalation of the dispute itself. Again, this cannot constitute in itself conclusive evidence, but nevertheless increases the plausibility of our explanation for gains and losses in this energy dispute.

The fact is that when Gazprom decided to stop all supplies to Ukraine, namely, reducing pressure in the pipeline running through Ukraine in accordance with volumes contracted to Ukraine, supplies started failing for consumers further West. In the center of the dispute lay the issue of technical gas, remaining to date unclear, whether either Naftohaz or Gazprom (or both) were responsible for this. It does not seem surprising that such supply problems should have happened. The question whether Gazprom shrewdly expected Naftohaz to be blamed for supply disruptions or naively expected Naftohaz to use technical gas from the general flow of natural gas and compensate consumers in the rest of Europe with emergency supplies from gas stored at the Western Ukrainian border, unfortunately remains unanswered. However, the fact is that volumes extracted by Ukraine did not correspond, in contrast to what was to happen three years later, to technical gas. This probably corresponded to strategy to create havoc with the goal to let Gazprom be blamed as ultimately responsible for natural gas supplies. In addition, the reaction in Europe was generally negative towards Gazprom and the Russian leadership.

Gazprom's reaction of taking the decision to restore supplies on 2nd January already, becoming effective on 3rd January is coherent to a correction after a miscalculation. This element supports the interpretation of the 4th January agreement as a compromise in view of its avoidance of further problems. This does not mean that Gazprom submitted to Naftohaz outright. Naftohaz had to accept higher prices (even if not as high as if the supply balance from 2005 had been maintained under higher prices from Gazprom), saw its participation reduced in the internal market and could not re-export natural gas anymore, which clearly affected the company's financial situation. It might be tentatively assessed that comparing the initial positions and the stakes involved, Ukraine ended up in a better position compared to Russia, whereas comparing financial losses for both Gazprom and Naftohaz, following Korchemkin's calculation, the latter ended up worse off. In any case, it cannot be stated that Russia and Gazprom reached their objectives in this dispute.

9. 3. Dispute of March 2008

The analysis of the second energy dispute is equally confusing at first sight, even if it leaves arguably fewer doubts compared to its predecessor. As explained in chapter 7, our assessment was also that the dispute's outcome could not be determined as a victory for the Russian side. Below comes a summing up of our reasoning.

The February Agreement

As was thoroughly analyzed in chapter 7, a debt dispute was at the center of this new energy dispute which led to partial gas cut-offs. The issue of Russian gas that had been shipped to Ukraine in order to guarantee normal supplies after a cold spell in Central Asia increased domestic consumption at the expense of supplies for Ukraine and a classic debt problem, compounded a situation where these factors were used by recently re-elected Prime Minister Yulia Timoshenko in an aggressive move to revise current agreements with Gazprom.

To offset the threat this new situation posed for Russia, Gazprom set a deadline for 12th of February. In case no payment was received, Gazprom would start reducing supplies in retaliation. The fact is that a meeting between Yushchenko and Putin that very day, managed to avert this. The agreement, as usual, raised controversy in Ukraine, as beyond offering a solution for the debt dispute, it introduced modifications into mutual energy relations: in line with Gazprom's already expressed desire to establish a joint venture to Naftohaz, this would be now effected, with RosUkrEnergo and UkrGazEnergo substituted. Even if this sounded as good news for Ukraine, the agreement apparently opened the door to increase Gazprom's presence in the Ukrainian internal market. As usual in such agreements, this might also be either the result of misinformation and distortions, possibly sought as a device to save face. Whether true or false, the fact is that Timoshenko quickly moved to nullify this agreement.

The March Agreement

As Timoshenko refused to abide by the Yushchenko sponsored agreement, the tension finally led to two days of partial cut-offs from 3rd to 5th March. With (not so) veiled threats to disrupt normal supplies, Gazprom soon restored full volumes to Ukraine. Negotiations continued until a new agreement was signed with the Ukrainian Prime Minister on 14th March. While solving the debt issue, this agreement proposed a new reorganization of energy relations, which confirmed some of the previous agreement's provisions, while it substantially changed other aspects. As already agreed in February, UkrGazEnergo would be eliminated, leaving the stage as soon as April, while silence prevailed regarding RosUkrEnergo, in spite of the frontal opposition professed by Timoshenko. As foreseen in the agreement of February, it was eventually to disappear in 2009. Indeed, it is fair to assume that Putin and Timoshenko were implicitly confirming the former dispositions and sealing its fate. The important fact is that the compensation to Gazprom for UkrGazEnergo's suppression was more meager than in the agreement in February.

Gazprom lost its indirect share of 25% in UkrGazEnergo, but would henceforth trade directly a volume of as much as 7.5bcm in the internal market of Ukraine. This would happen through a subsidiary company, "Gazprom Sbyt Ukraina". Controversy raged again, as there were doubts as to whether that was a minimum or a maximum. As in fact "Gazprom Sbyt Ukraina" eventually sold in 2008 only around 3bcm, it is probable that there was much of face-saving in these obscure provisions.

In general, this agreement represented a stalemate that solved the most pressing issues regarding debt while it introduced innovations in the status quo. In strict financial terms, it seems that Gazprom lost financially, while making no gains in political terms. Even if such a low scale dispute could hardly be decried as Gazprom's defeat, it is fair to use such denomination. Again, looking at the escalation pattern, Gazprom did not go beyond a partial cut-off of 50% of contracted volumes of natural gas and backtracked to continue negotiations. This behavior pointed to a high degree of care in the management of this dispute.

9. 4. Dispute of January 2009

We know already in full detail how the dispute of January 2009 unfolded and what were the fateful consequences for those countries engulfed in a supply crisis in the midst of a severe winter. This was explained in detail in chapter 8. The harshest dispute of all three analyzed is paradoxically the easiest to analyze when it comes to determining gains and losses for Gazprom. The dispute was a clear victory for Gazprom, even if both the financial and (potentially) reputational costs of the dispute itself were higher than ever.

As we saw in chapter 8, the dispute was the result of an unfortunate conjunction of debt issues and pricing discussions. Controversy remains regarding what happened exactly in the last hours of negotiations, but the fact is that the deadline was reached before a solution could be found for the price Ukraine would pay for natural gas in 2009. As had happened in negotiations both in 2007 and 2008, final prices had to be revised after Central Asian producers decided to raise prices for their natural gas sold to Gazprom (and later to RosUkrEnergo). If negotiations before went smoothly, the decision to reach "market prices", taken by Uzbekistan, Kazakhstan and Turkmenistan back in April, and which had to impact necessarily on Ukraine, represented this time an excessive increase for Kiev. Even if information is scarce, the truth is that new prices from Central Asia, as agreed by Gazprom, should have been set at

US\$330tcm. Gazprom was offering in the last negotiations prices around US\$250tcm to Ukraine, while it threatened to impose US\$410tcm instead if Ukraine rejected this offer.

After having imposed a gas cut-off to Ukraine first, and in the face of new flow disruptions harming European consumers, Gazprom progressively imposed a gas embargo, whereby the whole volumes of Gazprom's natural gas dried up during two weeks until an agreement was found on 19th of January. The agreement was valid for a period of ten years. According to the agreement, RosUkrEnergo was wiped out and as a corollary of this a confusing (and illegal) agreement was reached that enabled Naftohaz to take hold of RosUkrEnergo's reserves. The presence of RosUkrEnergo did not seem to be needed anymore, while Gazprom managed to impose prices of US\$410tcm, with Ukraine henceforth consuming Gazprom's natural gas from whatever geographical source the Russian monopoly deemed opportune. Prices would not be fixed to specific negotiations anymore, as had been done before 2006 and as had been renegotiated on a yearly basis until 2009 depending on prices in Central Asia. Pricing for natural gas would be based on the usual formula used in most of Europe for long-term contracts: natural gas prices were pegged to oil prices and would be recalculated every quarter of the year. Thus, prices announced were those valid for the first quarter of 2009.

As was natural, transit tariffs, which had been raised to 1.7tcm/100km in 2008, were now raised to 2.1tcm/100km (effectively 1.9tcm/100km for 2009 in virtue of the discount whose mention follows). However, the most substantial compensation for Ukraine was a discount of 20% for Ukraine, so the effective price for the first quarter was US\$360tcm. It is worth noting that this was exactly the price of natural gas imposed by the three Central Asian natural gas producers after the addition of transportation costs. We may surmise that Russia had modulated the price according to the margin left by these countries in order to enable a certain compromise with Ukraine and provide an easier escape from the protracted and harmful dispute. Still, this compromise was relative, as the discount was to be applied only to 2009. Besides this, in the long term, Ukraine had to fully accept market-based pricing imposed by Gazprom. Worse, Naftohaz had had to assume a calculation basis that was in every respect abusive: discounted prices made Russian natural gas supplied to Ukraine more expensive than the same volumes supplied by Gazprom to Central European countries, despite the obvious fact that these countries were geographically more distant. Once the discount was removed, and owing to fluctuations in oil prices, natural gas for Ukraine could in fact be even more expensive than in the far-away Germany.

As we know with the benefit of hindsight, discounts were renewed and even increased to 30% in April 2010, with Yanukovich as President of Ukraine, but in exchange for an extension of the lease

contract for the Russian Black Sea Fleet in the Ukrainian base of Sebastopol in the Crimean Peninsula, so instead of expiring in 2017, the contract was extended to 2037-42. Even under these new prices, prices were more expensive than natural gas in Central Europe. It is thus fair to state that Gazprom won this dispute, as it imposed all its conditions.

PART IV: PIPELINE POLITICS AND THE RISK FACTOR

Chapter 10: Pipeline Politics between Europe and Russia

10. 1. Introduction

As was considered in previous chapters, energy relations between Russia and its natural gas consumers are characterized by Gazprom's overwhelming dependence on European customers (at the time of writing, Europe's share of Gazprom's exports still dwarfs that of Asian countries, which is symbolic). This dependence is complemented by two more factors: first, most of the European countries consuming Gazprom's natural gas are part of the European Union's normative space. The EU's legislation, as we shortly reviewed in chapter 5, increasingly collides with Russia's normative philosophy. Second, and most relevant to our three case studies, transit of natural gas in the period 2005-2009 was overwhelmingly dependent on two countries: Belarus and Ukraine. This transit dependence was unbalanced: Belarus only played a marginal role, while Ukraine's share of Gazprom's transit of natural gas remained very high over the whole period. These circumstances greatly determine the context surrounding the three energy disputes analyzed in the preceding chapters.

Gazprom's natural gas exports and its dependence on Europe and the EU

As Gazprom's 2013 annual report shows, in 2013, Gazprom exports to the "European market", including Turkey (the report equates this area with the broad category of Far-Abroad)¹, represented 30% of these countries' natural gas consumption and 64,3% of their total imports.² If we put the EU market in a separate category, the figures were 29.3% and 43.1% respectively.³ However, as for Gazprom, there exists a clear unbalance, such that, as reviewed in chapter 2, has led many analysts to talk of asymmetrical interdependence in favor of the EU.⁴

Gazprom usually groups its sales into three categories: Russia, Former Soviet Union (FSU) and non-FSU countries. The latter category represented in 2013 32% of the total natural gas sales, and 55% of

¹ In Russia there is usually a distinction between two terms in order to identify countries abroad: Near and Far Abroad. This distinction is necessary in order to distinguish between countries belonging to the former Soviet Union (FSU), which fall into the category of Near Abroad, and the rest which falls into the Far Abroad.

² Gazprom (2013): "Annual report", p. 63, at <http://www.gazprom.com/investors/reports/2013/> (Accessed on the 6th October 2014).

³ *Ibid.*, *Idem*.

⁴ One of the best references to analyze the real nature of Europe's dependence on Gazprom and the limited character thereof, something quite often overlooked by many analysts and mostly, by un-careful press reports, is Pierre Noël: "Beyond dependence: how to deal with Russian gas", European Council on Foreign Relations, Policy Brief (7 November 2008), at http://ecfr.eu/page/-/ECFR-09-BEYOND_DEPENDENCE-HOW_TO_DEAL_WITH_RUSSIAN_GAS.pdf (Accessed on the 6th October 2014). This report, from six years ago, has not lost much of its actuality.

the sales revenue.⁵ If excluding Russia, and thus considering only sales abroad, sales to non-FSU represented 79.9% of the total.⁶ When we analyze the breakdown of the non-FSU category (Far-Abroad), which has an overwhelming importance within the general category of exports, we see that Europe in general, and the EU in particular, represent the major bloc of Gazprom's natural gas sales abroad. Most importantly, the presence of Asia is still marginal.

Gazprom's annual report states: "*Projects to supply up to 68 bcm of Russian natural gas per year to China along the western and eastern routes are among Gazprom Group's key business priorities*".⁷ As the same report highlights, a memorandum of understanding was signed in March 2013 to supply as much as 38bcm per year through a new route from Eastern Siberia.⁸ The route to China had been delayed for many years, mainly, as James Henderson explained, because of pricing disagreements, as Russia became trapped in the successful diversification efforts by Central Asia to China, so the latter did not need to yield to Gazprom's conditions. As for Russia's desire to activate the Western route first, which enables Gazprom to reroute Europe's imports and offers an additional tool of pressure,⁹ China finally agreed on a second deal in November 2014.¹⁰ The situation in Ukraine since late 2013,¹¹ arguably explains why Gazprom approved two projects where pricing rather reflects China's and not Russia's initial conditions.

In any case, supplies to China will become possible only in the next years. At the time of writing, Gazprom's only access to Asia, mainly Northeast Asia, is through LNG. As Henderson and Stern show, LNG exports, mainly from Sakhalin II, are the only resources from either Eastern Siberia or the Russian Far East that are commercialized abroad, with 2bcm of LNG per annum exported in 2013, and those go

⁵ "Annual report" (2013), *op. cit.*, p. 64.

⁶ Calculation by the author from: *Ibid.*, p. 63.

⁷ *Ibid.*, p. 70.

⁸ *Ibid.*, *Idem.*

⁹ Henderson, James: "The pricing debate over Russian gas exports to China", Oxford Institute for Energy Studies, NG 56 (September 2011), p. 2, at <http://www.oxfordenergy.org/2011/10/the-pricing-debate-over-russian-gas-exports-to-china-2/>.

¹⁰ Cunningham, Nick: "Russia in weak position for new gas deal with China", *CS Monitor*, 12 November 2014, at <http://www.csmonitor.com/Environment/Energy-Voices/2014/1112/Russia-in-weak-position-for-new-gas-deal-with-China> (Accessed on the 12th January 2015). For a thorough analysis on the power correlation between Russia and China regarding pricing policy, see: Belyi, Andrei: "Russia's gas export reorientation from West to East: economic and political considerations", *Journal of World Energy and Law*, 12 January 2015, at <http://jwelb.oxfordjournals.org/content/early/2015/01/12/jwelb.jwu037.full?keytype=ref&ijkey=r0CQFIQrtLYu8RD#abstract-1> (Accessed on the 13th January 2015).

¹¹ A thorough review of the events surrounding the "Euromaidan" and its aftermath, namely, Crimea's annexation and ongoing civil war in Donetsk and Lugansk, can be found in the following works: Wilson, Andrew (2014): *Ukraine Crisis: what it means for the West*, New Haven; London, Yale University Press; Sakwa, Richard (2015): *Frontline Ukraine: crisis in the borderlands*, London, IB Tauris and Howard, Colby and Pukhov, Ruslan (2014): *Brothers armed: military aspects of the crisis in Ukraine*, East View Press, CAST, Moscow.

almost exclusively to Eastern Asia.¹² Compared to the whole volume of natural gas exports to non-FSU countries, this represents a marginal 1.1%.¹³

Regarding the rest (98,9%) of non-FSU countries, natural gas exports are exclusively concentrated on the European market. As stated above, Gazprom includes one of its biggest consumers, Turkey, in this category. Turkey imported 26.7bcm in 2013, according to Gazprom's annual report.¹⁴ This represents a sizable share of 15.3% of all non-FSU exports in 2013. Thus, the bulk of Gazprom's exports within the non-FSU category goes to the EU market. If excluding LNG exports in the Far-East, Turkey's consumption and the minor volumes imported by Bosnia-Herzegovina, Serbia and Macedonia, which account for not even 2.25bcm,¹⁵ the EU market represents 82.31% of non-FSU markets. To this should be added volumes corresponding to consumption in Lithuania, Latvia and Estonia, which are included as FSU countries and which consume a total of 4.5bcm.¹⁶ The EU's share of total exports, according to its volume is 63.26% and 32% of total sales by Gazprom (that is, including Russia's internal market). However, given the price differential between non-FSU, FSU and Russian markets, the EU's share is higher when taking Gazprom's revenues into account. Both Non-FSU and the FSU market are based on market prices, as most countries already pay advantageous (unsubsidized) prices for Gazprom. The Russian market, on the contrary, is subsidized. Based on revenues, the Non-FSU (where, as we earlier saw, the EU represents 82.31% of all sales), accounts for 58.4% of Gazprom's revenues of natural gas sales (the bulk of its business); excluding Turkey, the Far East and America and the three non-EU Balkan consumers, while adding the three Baltic Republics, the EU market yields a total share of Gazprom's revenues, which is much higher than its share in volume of natural gas, which accounts for only 32%.¹⁷

¹² "Annual report" (2013), *op. cit.*, p. 71. It is interesting to note here, that Henderson and Stern provide a radically different figure: 14.6bcm only from Sakhalin II (Henderson, James and Stern Jonathan: "The potential impact on Asian gas markets of Russia's Eastern gas strategy", Oxford Institute for Energy Studies (February 2014), at <http://www.oxfordenergy.org/2014/02/the-potential-impact-on-asia-gas-markets-of-russias-eastern-gas-strategy/>, which according to Gazprom's Annual report, sold only 0.8bcm ("Annual report" (2013), *op. cit.*, p. 71). This is surprising as until late 2013, Gazprom had an exclusive right to export natural gas (see: Cunningham, Nick: "Russia takes steps to increase LNG exports", *Oil Price*, 23 November 2013, at <http://oilprice.com/Energy/Natural-Gas/Russia-Takes-Steps-to-Increase-LNG-Exports.html> (Accessed on the 7th October 2014).

¹³ Calculation by the author from: "Annual report" (2013), *op. cit.*, p. 64. Besides East Asia, some of the volumes are exported to America, as Gazprom shows for 2012: <http://www.gazprom.com/about/marketing/> (Accessed on the 8th October 2014).

¹⁴ "Annual report" (2013), *op. cit.*, p. 64.

¹⁵ Serbia consumed in 2013 2bcm, Bosnia-Herzegovina 0.2bcm, whereas Macedonia is credited for having imported less than 0.05bcm (see: *Ibid.*, *Idem.*).

¹⁶ Estonia consumed in 2013 0.7bcm, Latvia 1.1bcm and Lithuania 2.7bcm (see: *Ibid.*, p. 69).

¹⁷ Calculation by the author from: *Ibid.*, pp. 62-70.

Gazprom's natural gas exports to Europe and its dependence on transit countries

The figures above clearly show how the EU's normative may represent a threat for Gazprom. However, they also clarify Russia's dependency on transit countries like Belarus and Ukraine. These two countries are the necessary transit route for most exports of natural gas further West. Thus, Russia is trapped in a pattern of double dependence, for which it searches double diversification, from Europe as the main geographical area of consumption, and from the transit countries that lead to it.¹⁸ The picture that has been presented above is similar to what prevailed in the period 2005-2008, which corresponds to the three case studies analyzed in chapters 6-8. LNG exports from Sakhalin II had not begun yet, as the LNG export terminal was inaugurated in February 2009, one month after the 2009 January energy dispute.¹⁹ Thus excluding the marginal deliveries of natural gas to East Asia, the balance was almost the same as showed above.

In this section we do not focus on the balance of Gazprom's exports of natural gas to the EU, which we already discussed in chapter 5. On the contrary, here will be considered the impact of transit countries on Russia as a gas exporter. As has been showed, no other region (apart from the FSU and Russia itself) can balance the preeminence of Europe within the category of non-FSU natural gas sales. Then, with the collapse of the Soviet Union, the former Soviet republics of Belarus and Ukraine became independent, and Russia had to start relying on them as transit countries for all natural gas sales by Gazprom to Western and Central Europe and Turkey. The relevance of these two countries in general, and the enormous importance of Ukraine as opposed to Belarus, is manifest. More than the reliance on these two countries, the most troublesome element for Gazprom was the imbalance between Belarus and Ukraine. In fact, as a transit country, Belarus was marginal. The downside of relying on Ukraine had already become manifest during the 90s energy crisis (see chapter 4).

The pipeline infrastructure that was built during the Cold War privileged Ukraine over Belarus.²⁰ Four main gas trunks serving the bulk of European consumers, transit Ukraine: Bratstvo, Soyuz, Urengoi-

¹⁸ See: Götz, Roland: "Mythos Diversifizierung. Europa und das Erdgas des kaspischen Raums", Konrad-Adenauer-Stiftung, *Auslandsinformationen* (September 2007), p. 40, at <http://www.kas.de/wf/de/34.5/ac.archive/>.

¹⁹ The LNG terminal in Sakhalin II was a project that had nothing to do with the disputes between Russia and Ukraine in previous years. However, a link was made, at least at the rhetorical level, between Russian calls to geographically diversify its energy exports and the heavy publicity that was granted to this inauguration (see: Pardo, Eric: "Northern territories and Japan-Russia relations: latest developments under Prime-Minister Taro Aso", *UNISCI Discussion Papers*, no. 20 (May 2009), p. 229, at <http://pendientedemigracion.ucm.es/info/unisci/>).

²⁰ For a general picture of the pipeline system that was built over this period through Belarus and Ukraine (and Moldavia), and which is briefly explained below, see: Yafimava, Katja (2011): *The transit dimension of EU energy security: Russian gas transit across Ukraine, Belarus, and Moldova*, Oxford; New York, Oxford University Press, Map 4.1., p. 77. For a very illustrative explanation of the "cursed" inheritance of the USSR for both Russia and Ukraine, see: Balmaceda, Margarita

Uzhgorod and Progress: Bratstvo paradoxically developed out of Ukraine when this republic was the main producer of natural gas and it contributed to its overexploitation as its resources were needed to cover international demand, given the delay in exploiting Siberian fields.²¹ Starting from 1966 and expanding until 1980, mostly to Central Europe, but also to Western Europe,²² this pipeline became the first export outlet for Soviet gas and was later supplemented by the Soyuz pipeline.²³ Thereafter came the controversial construction of the second main route,²⁴ the Urengoi-Uzhgorod pipeline, also known at the time as Yamal, or "East-West", among those Western European countries who cooperated, as they were the customers for gas contracted through it. The pipeline was inaugurated in 1983, and was later supplemented by the parallel pipeline "Progress", built in cooperation with the CMEA countries.²⁵

In contrast to Ukraine, Belarus assumed a much more modest role, with the construction of the pipeline "Northern-Lights".²⁶ However, while much of the gas transported by this pipeline is meant for internal consumption of Belarus, the main export line that continues beyond the territory of the nowadays independent republic turns south into Ukraine's territory to join the main pipeline trunk.²⁷ Small pipelines branch out directly to Poland, Lithuania and even as far as Latvia, but represent very limited supplies. Thus, besides pipelines crossing Ukraine, with the end of the Soviet Union, Russia's Gazprom depended only on the small capacity of Northern Lights and the direct link to Finland, the "Finland Connector".

Ukraine's preeminence, coupled with the great capacity for underground storage it possesses in the Western part of its territory,²⁸ with a total capacity of 32bcm,²⁹ led to a share of 90% of Russian gas

(2013): *The politics of energy dependency: Ukraine, Lithuania, Belarus between domestic oligarchs and Russian pressure*, Toronto, Buffalo, London, University of Toronto Press, chapter 2.

²¹ Heinrich, Andreas (2014): "Introduction: export pipelines in Eurasia", in Heinrich, Andreas and Pleines, Heiko (eds.): *Export pipelines from the CIS region: geopolitics, securitization and political decision-making*, Stuttgart, Ibidem-Verlag, pp. 33-34.

²² The first country to receive Soviet gas was Austria, neighbor to Czechoslovakia, the main recipient of the pipeline. This episode is thoroughly described in: Högselius, Per (2013): *Red Gas: Russia and the origins of European energy dependence*, New York, Palgrave MacMillan, chapter 4.

²³ Heinrich, "Introduction: export", *op. cit.*, pp. 33-34.

²⁴ For the controversy it generated among Western allies, see chapter 5, p. 108 (ftn. 17).

²⁵ Heinrich, "Introduction: export", *op. cit.*, pp. 35-38.

²⁶ *Ibid.*, p. 35.

²⁷ Paradoxical as it may seem, the option of re-orienting some of the export lines through Belarus and Poland was excluded in itself for reasons similar to which today push Russia to avoid Ukraine. During the 80s, it was not considered politically safe to use the route of Poland, given its political instability and the danger of US sanctions if this was interpreted as support to the Polish regime (see: Victor, David & Victor, Nadejda Makarova: "The Belarus connection: Exporting Russian gas to Germany and Poland", *Geopolitics of Gas Working Paper Series*, Baker Center, Stanford (August 2004), pp. 28-29, http://iis-db.stanford.edu/pubs/20603/Yamal_final.pdf).

²⁸ Balmaceda, "The politics of energy dependency", *op. cit.*, p. 94.

²⁹ As seen in the previous chapters devoted to the energy disputes, gas stored in these facilities is vital for Gazprom's exports to the rest of Europe. For details on the underground storage capacity in Ukraine, see: IEA (2006): "Ukraine: energy policy review", pp. 208 (Box 6.2); 2012 (Table 6.1), at

<http://www.iea.org/publications/freepublications/publication/ukraine2006.pdf>.

transited to Europe.³⁰ Depending on whether Turkey is included or not in the category of Europe, this percentage is sometimes higher. However, as it is important here to take into account all customers who depend on transit countries, the inclusion of Turkey seems natural.

Gazprom's efforts to diversify away from Ukraine: the Yamal Pipeline and the Blue Stream

The extreme imbalance between Ukraine and Belarus as transit countries and the troublesome energy relation Russia had with the former, in sharp contrast to Belarus, made of the latter a suitable alternative to reduce dependence on Kiev and thus to mitigate the impact of the constant energy disruptions Gazprom had to suffer during that period.

Yamal Pipeline through Belarus and Poland

The project of building the Yamal Pipeline,³¹ or Belarus Connector, saw the light during the decade of the 90s. The project was born out of mostly commercial reasons, namely, to cover an increasing demand in Germany (and eventually Poland too), for which crossing Belarus and Poland represented the most direct and sensitive alternative. In addition, all the troubles that dependency on Ukraine caused, provided an additional argument for the spur's construction, aimed at reaching a capacity of as much as 67bcm per year.³² However, it was downsized as a response to lesser demand than initially planned. Therefore, instead of two spurs, only one was built. This spur reached an initial capacity of 20bcm,³³ with the potential to reach 33bcm if additional compressor stations were built.³⁴ The maximum was reached in 2006, six years after its going online.³⁵

Since then, this pipeline has not expanded its capacity. Russia favors the project of Yamal II,³⁶ which would add at least 15bcm (half of the second spur's capacity as originally planned).³⁷ This expansion was revived in 2013 and provoked a great deal of controversy in Poland: The Polish government disavowed a memorandum signed by EuroPolGaz, owner of the Polish section of the Yamal pipeline, to build the second pipeline. The goal of this pipeline was to serve Poland, Slovakia and

³⁰ Yafimava, "The transit dimension of EU energy security", *op. cit.*, p. 78, fn. viii.

³¹ As had happened with the "Urengoi-Uzhgorod" pipeline, which was originally called Yamal, the Belarus Connector was supposed to extract resources from the peninsula of Yamal, hence its original denomination. It suffered in this respect the same fate as its predecessor, as it remained too costly to tap resources from this region.

³² *Ibid.*, p. 21.

³³ *Ibid.*, *Idem.*

³⁴ *Ibid.*, pp. 26-27.

³⁵ Heinrich, "Introduction: export", *op. cit.*, p. 42.

³⁶ See: Heinrich, Andreas: "Poland as a transit country for Russian natural gas: potential for conflict", *KICES Working Papers*, no. 9-10 (September 2007).

³⁷ Heinrich, "Introduction: export", *op. cit.*, p. 43.

Hungary through Belarus instead of Ukraine,³⁸ reviving a project considered from 1992 to 1995, where a spur from "Northern Lights" would go directly to Slovakia and avoid Ukraine.³⁹ Since that rejection, the project remains abandoned.

Blue Stream from Russia to Turkey by the Black Sea

The other pipeline that was laid down recently and which strongly contributed to reduce Russia's Ukraine's share as transit country for Gazprom's natural gas exports, was the pipeline known as Blue Stream. Its reason to be, derived from the rate of increasing consumption in Turkey of natural gas, which during the 90s jumped from 6bcm in 1993 to 10,3bcm in 1998; according to assessments at the time, Turkey's consumption was to reach as much as 45bcm in 2005.⁴⁰

Blue Stream was the first underwater pipeline built by Gazprom, linking Russia directly to Turkey through the Black Sea. It was built in cooperation with the Italian ENI, who mastered the technique to build underwater pipelines. Russia and Turkey signed an agreement in December 1997.⁴¹ Its capacity was designed to cover a yearly volume of as much as 16bcm. The classic fears regarding energy cooperation with Russia and the possible dangers of dependency on Gazprom made the project controversial from its very beginning.⁴² However, the option of a direct link through the Black Sea still seemed better than laying the new pipeline through the troublesome Caucasus.⁴³

Its positive aspects may explain why the pipeline was finally built after all, in spite of initial reservations. However, the road to full implementation remained far from a quiet one. Initial disagreements started surfacing from the very beginning regarding prices and contracted volumes. Therefore, instead of 2003, when the pipeline was already fully operational, the inauguration ceremony took place only two years later.⁴⁴ Since then, far from 16bcm, the Blue Stream's capacity has remained underused.⁴⁵ It must be said that Blue Stream was projected and eventually built against the background

³⁸ "Poland: government plays down Gazprom-EuRoPol memo", *Natural Gas Europe*, 8th of April 2012, at <http://www.naturalgaseurope.com/gazprom-europol-yamal-pipeline-two> (Accessed on the 10th October 2014).

³⁹ Victor & Victor, "The Belarus connection", *op. cit.*, p. 29.

⁴⁰ "Iuzhnyi Potok (ЮЖНЫЙ ПОТОК)", *Neftegazavaia Vertikal*, 31 May 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

⁴¹ Bacik, Gökhan: "The Blue Stream project, energy cooperation and conflicting interests", *Turkish Studies*, vol. 2, no. 2 (Autumn 2001), p. 85.

⁴² *Ibid.*, p. 89.

⁴³ Krauer-Pacheco, Ksenia: "Turkey as a transit country and energy hub: the link to its foreign policy aims", *Forschungsstelle Osteuropa*, no. 118 (December 2011), p. 34.

⁴⁴ *Ibid.*, *Idem.*

⁴⁵ Heinrich, "Introduction: export", *op. cit.*, p. 43.

of mistrust between Russia and Turkey. Once Blue Stream's construction had been decided, Turkish officials' unease in regard to dependence on Russia played in favor of other alternative projects.⁴⁶

The entrance on the scene of the Baku-Tbilisi-Erzurum (BTE) Pipeline, also known as "Caucasus Pipeline", provided an additional source of gas for Turkey which arguably made unnecessary some of the supplies foreseen in Blue Stream. The BTE Pipeline was considered as soon as in 1999, when massive gas reserves were discovered in the Shah-Deniz field off Baku.⁴⁷ Negotiations on this new diversification route were finished in 2003, precisely when the Blue Stream had become operational. It was at the time considered the BTE pipeline would deliver 6bcm of gas to Turkey per year.⁴⁸ Deliveries to Turkey began in July 2007.⁴⁹ This competition between Blue Stream and the BTE pipeline has therefore greatly limited the former's relevance. As for projects to expand Blue Stream and add a second pipeline, Blue Stream II, both to expand supply to Turkey and supply other countries, as Greece and Italy, or even the Middle East, with Israel as the main customer,⁵⁰ these have not progressed since then.

Effects of Russia's Diversification on Ukraine's Share as Transit Country

With Yamal-Europe and Blue Stream, the period 2005-2009 saw a certain reduction of Ukraine's role as transit country, down from its share of 90% during the decade of the 90s.

As the report "Natural Gas and Ukraine's Energy Future", from the consulting company IHS CERA, shows, Ukraine's share as transit country for the category of Europe, hovered by 2004, already around the usually mentioned figure of 80%; the exact percentage for that year was 78%.⁵¹ From 2004 to 2008, a progressive reduction in Ukraine's share took place. This, however, did not rob Ukraine of its preponderance in terms of percentage: In 2006, only two years later, the percentage dipped below 70%, with 68%, while the year 2008 finished slightly over 70%.⁵² During this period, as explained above,

⁴⁶ Winrow, Gareth T.: "Turkish National Interests", in Kalyuzhnova, Yelena; Jaffe, Amy Myers; Lynch, Dov and Sickles, Robin C. (2002): *Energy in the Caspian region: present and future*, Houndmills, Basingstoke, Palgrave, p. 235, 244

⁴⁷ Babali, Tuncay: "Implications of the Baku-Tbilisi Ceyhan main oil pipeline project", *Perceptions*, vol. 10, no. 4 (Winter 2005), p. 50.

⁴⁸ Cornell, Svante; Tsereteli, Mamuka and Socor, Vladimir: "Geostrategic implications of the Baku-Tbilisi-Ceyhan pipeline", in Starr, S. Frederick and Cornell, Svante E.: "The Baku-Tbilisi-Ceyhan pipeline: oil window to the West", Central Asia-Caucasus Institute & Silk Road Studies Program (2005), p. 22.

⁴⁹ Heinrich, "Introduction: export", *op. cit.*, p. 67.

⁵⁰ Socor, Vladimir: "Gazprom, Turkey revive and reconfigure Blue Stream two", Jamestown Foundation, *Eurasia Daily Monitor*, vol. 6, no. 154 (2009 August 11), at [http://www.jamestown.org/single/?tx_ttnews\[tt_news\]=35394&no_cache=1#VD02nRbp_FY](http://www.jamestown.org/single/?tx_ttnews[tt_news]=35394&no_cache=1#VD02nRbp_FY) (Accessed on the 13th October 2014).

⁵¹ IHS CERA: "Natural gas and Ukraine's energy future", Ministry of Energy and Coal Industry of Ukraine (February 2012), p. 2-3 (27), Figure 2-3 "Transit of Gas Through Ukraine, 2004-10", at <http://s05.static-shell.com/content/dam/shell-new/local/country/zaf/downloads/pdf/research-reports/Ukraine-Policy-Dialogue-report.pdf>.

⁵² *Ibid.*, *Idem.*

Yamal-Europe expanded its capacity, while Blue Stream started operating, providing an additional source of gas for Turkey. Ukraine's share further sank in 2009, reaching as little as 62%.⁵³ The long-drawn energy dispute of January 2009 probably offers an explanation for this lower percentage. However, reduced consumption due to the financial crisis in Europe might also have played an important role: Gazprom could have prioritized Yamal-Europe over the export pipelines running through Ukraine, instead of reducing pressure proportionally in all export routes. The report though, does not specify which countries are included within the generic category of Europe. The obvious question is whether Turkey is included or not. This is relevant, as the inclusion or not of Turkey determines whether only Yamal-Europe, or Blue Stream too, is a cause for Ukraine's share variations.

In that respect, data from the IEA may be of some help.⁵⁴ According to both IHS CERA and the IEA (IEA Ukraine Policy Review 2006), in 2004 and 2005, the figure for total transit volume is slightly below 140bcm.⁵⁵ While no discrepancy on this figure exists, both reports, however, disagree on the percentage of natural gas that transits through Ukraine to Europe: 84% for the IEA,⁵⁶ versus 78%-76% for IHS CERA.⁵⁷ However, the IEA report from 2012 does provide more details on the destiny of supplies of gas transiting through Ukraine; instead of establishing the generic category of Europe, the 2012 Ukraine Energy Policy Review distinguishes between EU-27 and the rest, where Russia, the Balkans and Turkey are included.⁵⁸ Between 2005 and 2006, the volumes of natural gas for EU-27 transited through Ukraine suffer a sharp reduction, from slightly more than 120bcm to only above 110bcm, in what is roughly a reduction of 10bcm.⁵⁹ This coincides with the percentage calculated by IHS CERA, where 2005 corresponds to 76% and 2006 to only 68%.⁶⁰ A calculation of percentages from IEA data, equating the volume of 2005 in IEA to the percentage for 2005 provided by IHS CERA, yields a near coincidence when extrapolating to 2006.⁶¹ This may be an indication that the share calculated in IHS CERA under the

⁵³ *Ibid.*, *Idem*.

⁵⁴ "Ukraine: energy policy review" (2006), *op. cit.*

⁵⁵ *Ibid.*, p. 211, Figure 6.2 "Natural gas transit via Ukraine, 1991-2005"; "Natural gas and Ukraine's energy future", *op. cit.*, p. 2-3 (27), Figure 2-3 "Transit of Gas Through Ukraine, 2004-10". As the IEA report explains, these total volumes also included supplies to Southern Russia and other CIS countries; this is explained not only by the marginal volumes of natural gas supplied to Moldova, but also because a pipeline route crosses Ukraine in the North-South direction (see: *Ibid.*, p. 209, Figure 6.1 "Natural gas transportation system of Ukraine") to deliver gas in Southern Russia, and probably, the Caucasian republics too.

⁵⁶ "Ukraine: energy policy review" (2006), *op. cit.*, p. 204.

⁵⁷ The IEA does not specify to which year this percentage refers. However, as the report is from 2006, we may assume that it refers to the percentage of natural gas at the time of publishing, so it should apply, at the latest, to 2005.

⁵⁸ "Ukraine: energy policy review" (2012), *op. cit.*, p. 113, Figure 7.6. "Gas transit volumes via Ukraine, 1991-2011", at http://www.iea.org/publications/freepublications/publication/Ukraine2012_free.pdf.

⁵⁹ *Ibid.*, *Idem*.

⁶⁰ "Natural gas and Ukraine's energy future", *op. cit.*, p. 2-3 (27), Figure 2-3 "Transit of gas through Ukraine, 2004-10".

⁶¹ Figure 7.6 in "Ukraine: energy policy review" (2012), *op. cit.*, only provides the exact figure for units of 20; therefore, calculating the exact volume indicated for each year, yields a certain imprecision. Assuming, out of IEA data, 122bcm for 2006 and 112bcm for 2005, and equating 76% to the former figure yields the exact percentage of 69.7% vs. 68% in IHS CERA. The

denomination of Europe, corresponds to EU-27 and Yamal-Europe is responsible for the reduction. If this is so, the higher percentage by the IEA 2006, may account for the inclusion of Balkan and Turkey into the category of Europe.

It seems clear that the period 2005-2009 did see a reduction in Gazprom's dependence on Ukraine as a transit country. However, Ukraine's role as transit country remained important enough as for Ukraine to retain its importance. The entrance in action of Yamal-Europe and Blue Stream did not arguably lessen the perception of dependence of Russia on Ukraine. Blue Stream only contributed to Turkey's energy security, as only Ankara would henceforth enjoy the new pipeline's spare capacity to make up for eventual cut-offs in volumes transiting through Ukraine. As for the EU, its energy security slightly improved but not equally for all its members, as it was Poland and Germany, who by the inclusion of Yamal-Europe, enjoyed the most. Russia could not extricate itself from its dependence on Ukraine as the main transit route for its natural gas exports to Europe. The immediate and devastating effects of natural gas cut-offs may clearly appear after having read chapters 6 and 8, where the energy disputes of January 2006 and January 2009 led problems in energy supply.

This explains why Russia and Gazprom were eager to promote other projects to bypass Ukraine.

Alternative Diversification Routes for Gazprom before the period 2005-2009: the Baltic Option

As Victor and Victor show, at the time of planning the construction of the Yamal-Europe pipeline, the Russian side was also considering other options. One of them, as mentioned above, was to partly bypass Ukraine through Slovakia (see pp 313-314). This served as inspiration for the project of Yamal-II, which never saw the light of day.

Before the Orange Revolution in 2004, it is true that Gazprom even considered reinforcing Ukraine's role as transit country. It must be remembered that, as we analyzed in chapter 4, energy relations between Russia and Ukraine improved with the nomination by President Kuchma in 2000 of Viktor Yushchenko as Prime Minister and Yulia Timoshenko as Vice-Prime Minister for Energy Issues. Massive natural off-takes ceased, for which the entrance in service of Yamal-Europe in 2000 has been

percentage only slightly changes when assuming other similar values (122 +/- 2 or 112 +/- 2). Differences may account for imprecision or for the inclusion of European countries that enjoy direct supplies, namely, Finland and Estonia. Analyzing data from Gazprom (Annual Reports from 2005 (p. 54) and 2006 (p. 50), at <http://www.gazprom.com/investors/reports/2005/> and <http://www.gazprom.com/investors/reports/2006/>), transit through Ukraine would yield 79,8% in 2005 and 71,02% in 2006. Although different, they do show a similar variation as that seen comparing IEA and IHS CERA reports above. The percentage should increase if we add other countries, whose gas transits Ukraine, specially Turkey's substantial share.

credited as a disciplining element. Then after Yushchenko was fired, the pro-Russian turn taken by Kuchma led to the revival of talks concerning an energy consortium.⁶²

We had the occasion earlier to review every project of consortium considered in the 90s and we already know that each of them ended up coming to nil. The energy consortium discussed under Kuchma was the most promising project to date, even if a great deal of distrust still prevailed. Gazprom initially proposed an international consortium with the inclusion of Germany, which at the time was eager to increase gas sales. Germany's presence could serve to either increase Ukraine's trust, fearful as it was of seeing its energy infrastructures under Gazprom's control or boosting Russia's confidence that western interests would put pressure on Ukraine to avoid any disruption of natural gas flows.⁶³ The initiative of establishing a gas consortium and increasing gas flows through Ukraine was fostered indeed by the improved performance of Ukraine as transit country, but also by the state of decay of its infrastructures, which sorely needed investments. Any eventual gas consortium, prior to adding new capacity to Ukraine's GTS, would have to invest to avoid reduced capacity in the future.⁶⁴ At the initial stage, every partner was thought to have convergent interests. However, as we know, the Orange Revolution put the project back on the shelf.

The Baltic Option and the Birth of the Nord Stream Project

The limited potential of any added capacity of the Yamal-Europe project and the unrealistic prospects of establishing a gas consortium in Ukraine gave ground to consider other alternative projects. Chief among these was the so-called Baltic Pipeline, later renamed Nord-Stream, eventually built in 2011, and which is one of the three pipeline projects whose development during the period 2005-2008 is analyzed below.

The paradox was that while failure, or at least limited success (as was the case with Yamal-Europe) of previous by-pass projects, opened up the ground for new options, the same obstacles that accounted for their poor achievements, remained. Prospected consumption in Germany had proved less

⁶² It is during the second administration of Leonid Kuchma as President of Ukraine, that the Commonwealth of Independent States (CIS) Single Economic Space agreement was signed (Van Zon, Hans: "Political culture and neo-patrimonialism under Leonid Kuchma", *Problems of Post-Communism*, vol. 52, no. 5 (September/October 2005), p. 14). The scandal that had led to NATO's discovery that Ukraine had been selling military material to Saddam Hussein's Irak helped Ukraine's turn towards Russia and the CIS. At the same time, Kuchma had had to challenge Timoshenko's defiance, which led her to join protests against the President as a consequence of the truculent murder of the journalist Georgi Gongadze, after she had been expelled from the government. He eventually sacked his loyal Prime Minister, Viktor Yushchenko, fearful of his popularity, so his pro-Western government disappeared from the scene. However, besides these elements, the truth is that Ukraine's economy had strongly bounced back from years of destructive depression, mostly thanks to energy prices that were getting cheaper for Ukraine in comparative terms. In such a context, the pro-Russian turn made sense.

⁶³ Victor & Victor, "The Belarus connection", *op. cit.*, pp. 31-32.

⁶⁴ *Ibid.*, p. 31.

than expected (which led to the building of one instead of two spurs in the Belarus Connector). Neither could Russia convincingly make the case of increased production of natural gas to justify its new projects (The Belarus Connector as we know, only reached full capacity thanks to gas flows diverted from Ukraine). This was compounded, in the case of the Baltic option, by the ambitious scope of the project, which foresaw the construction of an underwater pipeline. This implied higher costs which made the project less competitive.

As had been the case with the Urengoi-Uzhgorod pipeline in the 80s,⁶⁵ and the Yamal-Europe later, resources from the region of Yamal,⁶⁶ challenging in terms of technical exploitation, had been promised as a supply basis. As the massive fields in the Yamal Peninsula were not developed on schedule, the Uzhgorod-Urengoi and Yamal-Europe pipelines had to draw natural gas from other sources. To date, the resource-rich region is fully explored but has not been developed yet.⁶⁷ If neither increased consumption nor new developments could be forecast and with limited potential already covered by Yamal-Europe, the prospects for the Baltic Option could only improve if a strategic choice for massively diverting gas flows from Ukraine was made. In fact, this is what eventually happened to Nord Stream when it came online from 2011-12: it remains underused and feeds mostly from gas previously transited through Ukraine. However, although the Ukraine- bypass option was probably considered in secret as the most reasonable option, Nord Stream would again brandish the promise of Yamal gas to reinforce its candidature.

In its very initial conception, Gazprom played on the expanded possibilities that the Baltic option could add. An underwater pipeline through the Baltic Sea offered a wider geographic reach compared to continental options like the Belarus Connector. Thus, already in 1990 (still under the Soviet Union), a British-Russian joint venture called *Sovgazco*, planned to service a large share of UK's demand which was expected to double (which in fact it mostly did) from 55bcm.⁶⁸ The project floundered, but the Baltic route had started nurturing new projects. Back in the 90s, after the fall of the Soviet Union, Gazprom was trying already to revive similar projects. The Russian state monopoly had in 1997 joined the Finnish

⁶⁵ See: Högselius, *op. cit.*, p. 180.

⁶⁶ Gazprom: "Yamal megaproject", at <http://www.gazprom.com/about/production/projects/mega-yamal/> (Accessed on the 16th October 2014).

⁶⁷ "*Being most explored and ready for development*" is how Gazprom refers to the Yamal Megaproject in its online brochure; see: *Ibid.*

⁶⁸ Victor & Victor, "The Belarus connection", *op. cit.*, p. 32.

Neste Oil and it created a joint venture to lay a pipeline across the Baltic Sea. German Ruhrgas soon joined them.⁶⁹

Improving relations with Ukraine in the first years of the 2000s decade, however, reduced the need for diversifying and the Baltic option lost momentum. According to Per Högselius, the worsening of relations with Belarus, the very country that had appeared as the most viable alternative to Ukraine and with whom Gazprom had an energy dispute in January-February 2004, encouraged Russia to reconsider the Baltic option.⁷⁰ The start of what would soon be known as the Nord Stream project (renamed so in 2007), thus happened in 2005, some months before the momentous gas dispute between Ukraine and Russia in January 2006. In September 2005 an agreement was signed for the construction of the North European Gas Pipeline Co. (NEGP), which would be initially formed by Gazprom (51%), Ruhrgas-E.ON (24.5%) and BASF (24.5%).⁷¹ The project was favorably received in the European commission, which in fact had already named the NEGP pipeline as a project of interest back in 2000.⁷²

The "anti-Gazprom" diversification alternatives: the trans-Caspian route and Nabucco

Not only Gazprom and the Russian government were moving to eliminate or at least reduce insecurities derived from dependence on Eurasian energy tremors. If from the perspective of Russia excessive dependence on transit countries is troublesome, especially given the experience of the 90s with Ukraine, dependency in general is not wanted by any actor involved in complex energy relations. Russia has, as analyzed in this chapter, a heavy degree of dependency on EU countries and can hardly expect to remove that dependency, at least in the short term. However, from the perspective of European consumers, dependency on Russia can also be seen as troublesome in itself, either through fear of an eventual political use of its natural resources, or as a result of the very same problems that stem from the troubled Russia-Ukraine energy relations.

Diversification from Russia thus had already become a very current topic in the 90s, when problems became manifest. Central Asian and Caucasian natural gas resources soon appeared capital as a basis for diversifying away from Russia. EU countries, complementary to Russia as consumers of Gazprom's gas, thus became potential competitors of Russia for the control of resources in the former

⁶⁹ Lochner, Stefan and Bothe, David: "From Russia with gas: an analysis of the Nord Stream pipeline's impact on the European gas transmission system with the Tiger-Model", *EWI Working Paper*, no. 07.02 (2007), p. 1, at <http://www.ewi.uni-koeln.de/en/publications/working-papers/#c373>.

⁷⁰ Högselius, *op. cit.*, p. 215.

⁷¹ *Ibid.*, *Idem.*

⁷² Smith, Hanna: "Politicizing energy security: Russia and the European Union", in Oxenstierna, Susanne and Tynkkynen, Veli-Pekka (2014): *Russian energy and security up to 2030*, London, New York, Routledge, p. 88.

Soviet space.⁷³ Turkey was also as much a partner as a competitor of Russia, as it was a consumer and the necessary transit country both for Gazprom's projects like Blue Stream and South Stream and for Trans-Caspian projects.

Diversification projects from Central Asia

Diversification started with oil resources from the Caspian Sea, in what was known as the new "Great Game". Western oil companies rushed to the region as soon as the fall of the Soviet Union opened up the access to new hydrocarbon resources. As Pavel Baev shows, much of the hype was based on fantastic assessments of real resources and on equally flawed assumptions of profit margins.⁷⁴ However, a certain success was reached with the creation of the Caspian Pipeline Consortium (CPC) and the inauguration of the Tengiz-Novorossiisk pipeline from the Caspian Sea to an export terminal in the Black Sea, operative since 2001. This pipeline, the only one in Russian territory not owned by Transneft, benefits Russia, as it does not bypass it. The eventually limited resources in the Caspian region reduced the danger for Russia to see its monopsony challenged. However, The Baku-Tbilisi-Ceyhan (BTC) oil pipeline, agreed on between 1999 and 2000,⁷⁵ and inaugurated in 2006, in parallel to the above-mentioned Baku-Tbilisi-Erzurum (BTE) gas pipeline (inaugurated that same year), did challenge Russia to a larger extent. These new pipelines started supplying international markets with Azerbaijan's resources through Georgia and Turkey in avoidance of Russia. The same as with oil, natural gas was the object of similar games, focusing on the main producers of natural gas in the region, Turkmenistan and Azerbaijan.

The great new natural gas game

From the very beginning of post-Soviet independence, Russia understood that Turkmenistan, the main gas producer from Central Asia, represented a dangerous competitor. Even if it remained an important independent supplier of gas to Ukraine until 2006 (see chapter 6), Gazprom had already closed in October 1993 the door to direct supplies to Europe, after they had been initially allowed.⁷⁶ Consumer countries within the post-Soviet space, such as Ukraine, Azerbaijan and Armenia became the only alternative for

⁷³ As Margarita Balmaceda explains, instead of increasing efficiency at home and developing costly new fields in the Russian territory, Gazprom and the Russian state behind it, preferred to hold its grip on Central Asian natural gas resources to complement both Russian consumption and export commitments (see: Balmaceda, "The politics of energy dependency", *op. cit.*, pp. 65, 77).

⁷⁴ Baev, Pavel: "Assessing Russia's cards: three petty games in Central Asia", *Cambridge Review of International Affairs*, vol. 17, no. 2 (2004), p. 276.

⁷⁵ Marquina, Antonio (2008): "The Southeast-Southwest European energy corridor", in Marquina, Antonio (ed.): *Energy security: visions from Asia and Europe*, New York, Palgrave Macmillan, p. 59.

⁷⁶ Cutler, Robert M.: "Turkey and the geopolitics of Turkmenistan's natural gas", *Review of International Affairs*, vol. 1, no. 2 (Spring 2003), p. 22.

Turkmenistan.⁷⁷ This tied Ashgabad to Russia, whose territory was essential for accessing these countries, and worse, to Ukraine as its main consumer. Finding new outlets and escaping the devastating consequences of depending on such an unreliable customer as Ukraine, became imperative. From the other side of the Caspian Sea, Europe and Turkey were also sensing the opportunity.

The idea of transporting natural gas from the Middle East through pipelines appeared first in the 70s. Back then, the project was to export Iran's gas through Turkey all the way west to Europe.⁷⁸ The project floundered after the Iranian Revolution, but the fall of the Soviet Union opened promising new prospects. Thus, in the early 90s, a project was already being considered to lay a pipeline from Turkmenistan to Turkey through Iran, in order to transport 15bcm of natural gas for Turkey's domestic market.⁷⁹ Funds however, could not be found, as the US remained adamantly opposed to any form of energy partnership involving Iran.⁸⁰ This shattered the project's prospects. In the meantime, Turkey also favored a technically more complicated route crossing the Caspian Sea underwater and which would remove any possible inconvenience from the Iran side. Henceforth, most of the projects in the region necessarily involved the Caspian as the most suitable route. To reinforce its prospects, newly discovered resources from Azerbaijan's huge deposits of Khan Deniz soon appeared.

An additional factor which imposed celerity was that the window of opportunity might be closing as other actors entered the fray. Turkmenistan's position made it the object not only of Europe, Turkey and Russia's competition. Knocking on the door were also Iran, Pakistan and China.⁸¹ Before China reached an agreement in 2009 and changed the whole energy equation in the region,⁸² only Iran had offered so far a modest option for diversification to Turkmenistan. This happened with the Korpedzhe-Kurt-Kui pipeline, built in 1997 and where limited volumes of natural gas (the pipeline remained below capacity) were exported.⁸³ This diversification outlet further developed its potential in the coming years with the construction of two more pipelines, Artyk-Loftabad in December 2000 and Dauletabad-Sarakhs-Khangiran in 2010.⁸⁴ Before the appearance of China in the complex game and given the impossibility of

⁷⁷ *Ibid.*, *Idem.*

⁷⁸ Högselius, *op. cit.*, pp. 172-177.

⁷⁹ Cutler, *op. cit.*, p. 22.

⁸⁰ Olcott, Martha B.: "International gas trade in Central Asia: Turkmenistan, Iran, Russia and Afghanistan", *Geopolitics of Gas Working Paper Series*, n° 28, Baker Center, Stanford (May 2004), p. 12.

⁸¹ *Ibid.*, pp. 1-2.

⁸² For an analysis of the successful diversification policy by Turkmenistan in the period 2009-2011, see: Horák, Slavomír: "Turkmenistan's Shifting Energy Geopolitics in 2009-2011", *Problems of Post-Communism*, vol. 59, no. 2 (March/April 2012), pp. 18-30.

⁸³ Heinrich, "Introduction: export", *op. cit.*, p. 54.

⁸⁴ *Ibid.*, pp. 54-55.

building any pipeline through Afghanistan which might reach Pakistan, the turf remained, though, mostly in the hands of Russia from one side and Europe/Turkey from the other.

A variant of the initial Turkmenistan-Iran-Turkey project resurfaced in the late 90s, which more ambitiously, would have transported gas beyond Turkey to Bulgaria and further into Europe, to potentially reach the German market.⁸⁵ If this time the US administration, eager to promote diversification routes from Central Asia, seemed to be favorable, the eventual fall in demand by the Turkish market, beset by a financial crisis in 1999, and the increase of supply (see Azerbaijan and Russia) reduced the whole project to a single pipeline of Iranian gas to Turkey, inaugurated in 2001.⁸⁶ Eventually, the Korpedzhe-Kurt-Kui pipeline was upgraded in 2006, so finally 6bcm of Turkmen gas could be exported to Turkey through Iran.⁸⁷

The birth of Nabucco

The flurry of projects that had been planned in the 90s and that either failed or materialized in downsized versions, was only the beginning of the Trans-Caspian dreams and the precursors of the most defined version, in competition with parallel Russian projects as Nord Stream and eventually South Stream, the Nabucco pipeline.

The idea of Nabucco was voiced first by the US in 1996.⁸⁸ However, it was not until 2002, that the project received its current name. It was at the time, the Austrian OMV and the Turkish Botas who had the idea to name the future pipeline from Verdi's homonymous opera.⁸⁹ Soon after this, along with the Austrian and Turkish companies, gas companies from Bulgaria, Rumania and Hungary joined the project and signed a declaration of intent to build the pipeline.⁹⁰ As had been the case with Nord Stream, Nabucco attracted the interest of the European Commission as a project of diversification, in line with the spirit of the Green Paper published two years before on the security of energy supply.⁹¹ The Green Paper,

⁸⁵ Olcott, "International gas trade in Central Asia", *op. cit.*, p. 15.

⁸⁶ *Ibid.*, pp. 15-16.

⁸⁷ Götz, "Mythos Diversifizierung", *op. cit.*, p. 51.

⁸⁸ "Gazirovannaia strategiia (ГАЗИРОВАННАЯ СТРАТЕГИЯ)", *Neft Rossii*, 5 July 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

⁸⁹ Götz, Roland: "Die Nabucco-Gaspipeline: Probleme und Alternativen", *Osteuropa-Wirtschaft*, vol. 54, no. 1-2 (2009), p. 2.

⁹⁰ Kardas, Saban: "Geo-strategic position as leverage in EU accession: the case of Turkish-EU negotiations on the Nabucco pipeline", *Southeast European and Black Sea Studies*, vol. 11, no. 1 (March 2011), p. 39.

⁹¹ *Ibid.*, p. 38.

among other objectives, focused on diversifying the geographic origin of energy sources and sources of supply.⁹²

Three years later, in June 2005, the five shareholders signed an agreement to establish a joint venture, and more importantly, they started contacting potential suppliers, such as Azerbaijan and Iran.⁹³ As we will see below, Nabucco's ambition was to open up for Europe's market natural gas resources from the Middle East and Central Asia. However, it would soon face a set of problems that were clearly almost unsolvable. Among these were the impossibility of securing enough resources for its first stage, where Azerbaijan was to be an essential piece and the difficulty to link up with Turkmenistan, both for geographical and political reasons: laying an underwater pipeline through the Caspian Sea was complex and onerous, while Turkmenistan was developing a very fruitful multivectorial energy diversification policy, in which both Russia and mainly, China, were better positioned. However, the main obstacle, from which derived the two previous ones, was the US obduracy at allowing energy cooperation with the most promising potential partner: Iran. Iran's participation in the Nabucco project would have enabled, not only substantial resources, but also allowed a much easier connection with Turkmenistan. In addition to difficulties with suppliers, Nabucco's partners, paradoxically concerned with dependency on Russian natural gas and disruptions related with transit countries like Ukraine, had to face the disadvantage of cooperation with a potential transit country, Turkey, far from being a comfortable one.

In any case, Nabucco was to receive a clear boost as a consequence of the January 2006 energy dispute, which played into the narrative favorable to diversification.

10. 2. Pipeline Projects from the Post-Soviet Space from 2006 to 2009: Competence between Nabucco and Nord and South Stream

This section will review the evolution of three major pipeline projects, Nord Stream, South Stream and Nabucco, which were developed partly during the period 2006-2008, from the beginning of the January 2006 dispute (chapter 6), to the last dispute in January 2009 (chapters 7 and 8). As shown above, Nord Stream and Nabucco existed already as potential projects, even if still at very early stages, before the beginning of the whole period 2006-2008. The interest of a detailed analysis exclusively concerning this

⁹² Akil, Hakki: "Turkey's role in European security as the epicenter of regional energy routes", *Turkish Policy Quarterly*, vol. 2, no. 3 (Fall 2003), p. 4.

⁹³ Kardas, *op. cit.*, p. 39.

period, lies in the influence these diversification projects might have had on the genesis and course of the disputes.

As was already explained in the introductory chapter, we choose these three pipelines for their explicit character as either (in a simplified fashion) pro- or anti-Russian. This is enabled by the fact that from one side, Nord Stream and South Stream, reinforce or at least maintain dependency on Gazprom, while offering routes that reduce Ukraine's importance as a transit country, either adding new natural gas (thus reducing Ukraine's share) or diverting gas previously transited instead. In this respect, both pipelines, which we can identify as diversification projects *from* transit countries, fit into the narrative of producers (Russia and Gazprom in this case) and consumers (EU countries in this case) having a common interest in avoiding Belarus and Ukraine.

From the other side, Nabucco instead of reinforcing or consolidating EU's energy relations with the Russian Federation, pursues the creation of a new route from the Middle East and Central Asia. If initially focusing on Iran, Nabucco soon took in its inception a more challenging turn to Russia, when it started mainly targeting Azerbaijan and Turkmenistan's natural gas resources. Nabucco thus became a challenger of Gazprom's monoposony in the post-Soviet space. In this respect, Nabucco perfectly fits into the contrary narrative of avoidance of Gazprom as a troublesome partner.

Nord and South Stream from one side and Nabucco from the other, represent opposite lessons drawn from energy disputes between Russia and transit countries such as Belarus and Ukraine.⁹⁴ We will start our analysis from 2006 and not from 2005, as in chapter 6, for two reasons: first, the stage of development of both Nord Stream and Nabucco during 2005 was still very embryonic, while the project of South Stream did not even exist. Second, it is reasonable to consider the progress of these projects as a direct feedback of what "lesson" was extracted after January 2006 and to see whether Russian management of the two following disputes in March 2008 and January 2009 has a correlation with their progress.

Of course, diversification policy is not the only element that can be considered as a sign for the Russian federation of what direction the European Union in general, and its members in particular were moving to and to assess the existing risk of a backlash as a result of disputes with transit countries, where Russia might be held responsible. As we briefly reviewed in chapter 5, these years witnessed an

⁹⁴ This geopolitical opposition between both Nord and South Stream and Nabucco and their opposing goals in diversification, is already mentioned in: Finon, Dominique: "L'Échec économique de Nabucco: leçons pour la politique gazière étrangère de l'Union Européenne", *Revue de l'énergie*, n° 598 (November- December 2010), p. 371.

increasing opposition between the EU integrationist and market-based approach and the Russian the bilateral and state-based approach. An increasing gap regarding the Energy Charter Treaty, the deepening of EU energy integration through its successive energy packages and the expansion of the Energy Community (Ukraine became a member in 2011) was steadily developing during these years.

Neither do we have to look exclusively at the EU's responses in the energy realm. Some of the Russian Federation's actions may be enlightening in themselves. The Russian demand in the G8 Summit in Saint-Petersburg, 15-17 July 2006, which was devoted to energy security, to broaden the concept of energy security to include along with security of supply for consumers, security of demand for producers, as well as the proposal at the Summit with Germany in October of that same year to establish an energy partnership between Moscow and Berlin, were moves aimed at securing a suitable position as an energy partner. The Russian project of creating a natural gas OPEC was clearly more proactive and aggressive, as it was intended to nullify the margin of action of the EU countries to diversify away from Gazprom in the international market.⁹⁵

However, many of these initiatives failed to concretize beyond mere declarations. As for the implementation of real diversification, not just the promotion of policies of diversification, tracking the progress of the pipeline development remains the best indicator. It must be pointed out that while neither Russia managed to escape dependence on the EU (see pp. 308-310), nor did Europe significantly diversify its imports of consumed natural gas or started prioritizing other energy sources. In the period comprising the three years between 2006 and 2008, the EU's consumption of Gazprom's energy sources remained stable; in fact, it even increased in 2007 from 166.4bcm to 173.8bcm.⁹⁶ Besides, whatever reconsideration of the Russian Federation as a suitable partner would hardly have happened so swiftly in any case. Thus, between general guidelines and declarations on diversification and energy security from the part of the EU, and concrete steps of geographical diversification in natural gas supply that may be tracked through progress on pipeline development, we will choose a detailed analysis of the latter. It must also be taken into consideration that these pipelines retained a non-negligible geo-political importance for the Russian Federation's foreign policy beyond its immediate energy consequences, eager as Moscow

⁹⁵ On the natural gas OPEC, see: Butrin, Dmitrii'; Grib, Natalia and Ezh, Petr: "Energogazavat (Энепрогазават)", *Kommersant*, 30 January 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

⁹⁶ See: Dickel, Ralf; Hassanzadeh, Elham; Henderson, James; Honoré, Anouk; El-Katiri, Laura; Pirani, Simon; Rogers, Howard; Stern, Jonathan & Yafimava, Katja: "Reducing European dependence on Russian gas: distinguishing natural gas security from geopolitics", *Oxford Institute for Energy Studies*, NG 92 (October 2014), "Table 1: Russian Gas Exports to European Countries 2003–2013 (bcm*)", p. 3, at <http://www.oxfordenergy.org/2014/10/reducing-european-dependence-on-russian-gas-distinguishing-natural-gas-security-from-geopolitics/>.

was to maintain and improve bilateral ties with key partners in Western Europe (see: Germany and Nord Stream) and to avoid foreign penetration of its Near-Abroad (see: Nabucco and Turkmenistan). The importance that Moscow attributed to these pipelines fortunes as signal was probably quite high.

Below zed in three different sections, the development of Nord Stream, South Stream and Nabucco_are analyzed.

Nord-Stream

As we had occasion to mention above, Nord-Stream had already been shaped before the January 2006 dispute happened. Then, after remaining dormant for a long period, it found a significant boost in the new conditions created by the turbulences of Russia-Ukraine energy relations in the period that concerns us.

Nord Stream and the January 2006 Dispute

The backlash from most European countries, outraged by the supply disruptions that ensued for a period of three days as a result of the January 2006 dispute, was a blow to Gazprom's prestige, as Russia was generally blamed instead of Ukraine. However, Gazprom could also seize the occasion to blame Ukraine, promote another narrative and call for either explicitly bypassing Ukraine or for complementing that dependency with new and direct supplies. This was what the Baltic pipeline offered, namely, an alternative devoid of any worrisome transit countries. It is interesting to consider that, while the effects of the dispute, discursively negative for Gazprom, spurred Nabucco's *raison d'être* (see below), a substantial interest for Nord Stream remained. More than that, the European Commission, one of the main supporters of Nabucco, nevertheless had to acknowledge, in the face of the outspoken opposition from the part of the Baltic Republics and Poland, that it could not influence private interests promoting the Baltic option.⁹⁷ True to the previous commitment by the EU to support the NEGP, the Commission would confirm in February 2007 the status of Nord Stream as a priority project,⁹⁸ which, as mentioned already, had been granted back in 2000.⁹⁹

The particular dimension of private interests created a second layer, where geopolitical priorities derived from the interpretations of the dispute of January 2006 were put aside in favor of strictly

⁹⁷ Sapun, Alla: "Truby i trubachy (Трубы и трубачи)", *Neftegazovaia Vertikal'*, 21 March 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

⁹⁸ "V Evrokomissii SEG nazivaiut "prioritetnym proektom" (В Еврокомиссии СЕГ называют приоритетным проектом)", *RusEnergy*, 20 February 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

⁹⁹ "Sergei' Serdiukov: my derzhimsia vdali ot mezhdunarodnoi' politiki (Сергей Сердюков: Мы держимся вдаль от международной политики)", *Vremia Novostei'*, 5 June 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

economic interests. It is in this respect interesting to consider the support provided by the Minister of Energy from the UK to the Baltic project, eyeing the potential for additional consumption of Russian gas to the current energy mix¹⁰⁰ and the fact that the Dutch "Gasunie" signed with Gazprom in November 2006 to join Nord Stream.¹⁰¹ After this, the breakdown in Nord Stream was arranged as follows: Gazprom 51%, E.ON 20%, BASF 20% (both down from 24.5%) and Gasunie 9%.¹⁰² Successes in the coming months in 2007 with "unexpected" partners continued, as when for example, the British "Centrica" expressed the possibility of creating a joint venture with Gazprom, eyeing precisely 2010, the year when Nord Stream's first spur was to be inaugurated.¹⁰³

Cooperation with Gaz de France (GDF)-Suez, one of the key partners for Gazprom (France being an important consumer of Russian natural gas),¹⁰⁴ was reinforced when supply contracts were renewed before expiry and subsequently extended until 2030. In exchange for exports from the future Nord Stream, Gazprom gained direct access in the upstream market in France.¹⁰⁵ This was a good sign, as in fact GDF-Suez would eventually become a partner in the project. Wintershall (BASF energy subsidiary) made a promise to invest in Nord Stream in March 2007 represented an additional and clear support to the project.¹⁰⁶ Further, Wingas Transport (Wintershall-Gazprom JV) pledged to build two pipelines to connect Nord Stream with the German network: OPAL and NEL.¹⁰⁷ RWE would later start the construction of a pipeline in the Czech Republic which connected the country to Nord Stream.¹⁰⁸

¹⁰⁰ Sapun, *op. cit.* In fact, as Ruprecht Polenz, Head of the Committee on Foreign Affairs of the German Bundestag, had argued in an interview in November 2006, if the route through Belarus and Poland was justified as the best one to export to Europe resources from the Yamal area, natural gas from the Barents area and from the offshore Shtokman field would reasonably be exported through the Baltic (see: Grivach, Alexei': "Prizrak brodit po Evrope (Призрак бродит по Европе)", *Vremia Novostei'*, 29 November 2006 (Accessed on the 17th April 2013, from Integrum, Helsinki University). The credibility of Nord Stream was thus intimately linked to new resources from a different geographical area.

¹⁰¹ Grivach, Alexei': "Gasoprovodnye deviat' protsentov (Газопроводные девять процентов)", *Vremia Novostei'*, 6 October 2006 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁰² Grib, Natalia: "Gazprom zaslužil sebe luchshuiu doliu (Газпром заслужил себе лучшую долю)", *Kommersant*, 6 October 2006 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

¹⁰³ Gavshina, Oksana: "SP ili shto-to bol'shee (СП или что-то большее)", *Gazeta*, 6 March 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁰⁴ Gazprom exported 10bcm of natural gas to France in 2006, so the country represented the 4th biggest consumer after Germany, Italy and Turkey (see: Dickel et al., *op. cit.*, p. 3).

¹⁰⁵ Gavshina, Oksana: "Gazprom voi'det v doma frantsuzov (Газпром войдет в дома французов)", *Gazeta*, 20 December 2006 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁰⁶ Grib, Natalia: "Wintershall investiruet v Nord Stream (Wintershall инвестирует в Nord Stream)", *Kommersant*, 26 March 2007 (Accessed on 21st February 2013, from Integrum, Helsinki University).

¹⁰⁷ "Nord Stream obespechaet truboprovodami (Nord Stream обеспечат трубопроводами)", *Neftegaz.Ru*, 28 March 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁰⁸ "Podrazdelenie nemetskoï RWE postroit v Chekhii truboprovod v za 55 mln. evro (Подразделение немецкой RWE построит в Чехии трубопровод в за 55 млн евро)", *RusEnergy*, 22 May 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

For sure, cooperation at the private level was not devoid of obstacles, though. A clear sign of this was when Gazprom showed how far it was ready to yield to its partners in order to increase the whole project's attractiveness: in an agreement signed on 29th August 2006 with its main partners (when the name of the North European Gas Pipeline Company (NEGP) was officially changed to "Nord Stream"), Gazprom accepted that its subsidiary "GazExport" would pay Nord Stream all costs of transporting the maximum of 27,5bcm of the first tranche's total capacity, and that independently of whether buyers were found or whether any gas actually flowed.¹⁰⁹ Gazprom was ready to subsidize Nord Stream directly.

In the summer 2007, then, Gazprom faced certain difficulties with both E.ON and Gasunie. The main contention with the former concerned the way active assets would be swapped in the "Yuzhno-Russkoe" natural gas field. This field had to supply the future pipeline: Gazprom claimed that in exchange for the shares it was offering to E.ON, the German company offered in exchange underpriced assets in E.ON Foldgaz Storage, E.ON Foldgaz Trade and E.ON Hungaria.¹¹⁰ E.ON's permanence in Nord Stream was even called into question by this disagreement. Confirming the entrance of the Dutch Gasunie in Nord Stream was thus crucial to exert credible pressure on E.ON. However, problems with Gasunie also surfaced: Gazprom was not satisfied with the shares Gasunie offered in the pipeline Balgzand Bacton Line (BBL), which connected the Netherlands with the United Kingdom in exchange for its participation in Nord Stream.¹¹¹ E.ON, by the way, proposed to complement its assets in Hungary with part of its shares in electric infrastructures in the UK.¹¹²

In November 2007, after initial disagreements during the summer, the definitive entrance of Gasunie into Nord Stream was decided.¹¹³ This clearly reinforced the project of Nord Stream, increasing the support from one additional European country, precisely in a moment in which the offensive from the Baltic countries was very strong (see below), securing financial investments for the pipeline too. At that

¹⁰⁹ "Gazprom" pristupaet k stroitel'stvu gazaprovoda v Evropu na nevygodnykh usloviakh (Газпром приступает к строительству газопровода в Европу на невыгодных условиях)", *RusEnergy*, 4 September 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹¹⁰ Gavrish, Oleg: "Gazprom pereotsenil aktivy E.On (Газпром переоценил активы E.On)", *Kommersant*, 26 June 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

¹¹¹ Grib, Natal'ia and Gavrish, Oleg: "V severnyi potok potrebovali novykh vlivanii' (В северный поток потребовали новых вливаний)", *Kommersant*, 7 July 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹¹² "'Gazprom' posvetit Anglii ('Газпром' посветит Англии)", *Vedomosti*, 9 August 2007 (Accessed on the 8th April 2013, from Integrum, Helsinki University).

¹¹³ "'Gazprom' podpisal soglasenie s Gasunie ob ee uchastii v Nord Stream ('Газпром' подписал соглашение с Gasunie об ее участии в Nord Stream)", *RusEnergy*, 6 November 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

time, there was also talk of the possible entrance of British Petroleum (BP).¹¹⁴ Gasunie became officially holder of 9% of Nord Stream in June 2008.¹¹⁵

Nord Stream, and the delicate balance of Gazprom in the EU

However, the essential piece in any possible success of Nord Stream was the first geopolitical layer. Here the determining factor was the interplay between Russian and German interests. Unfortunately for Russia, relations with Germany were not necessarily as friendly as they might have appeared. Several changes had happened in Berlin that cast doubt on the resilience of the staunch German-Russian partnership. As a result of parliamentary elections in September 2005, Germany was henceforth ruled by a grand coalition between the CDU/CSU and the SPD, with the Christian-democrat Angela Merkel as chancellor. The former chancellor Gerhard Schroeder became Chairman of the Shareholders Committee of Nord Stream, while the more Russia-friendly SPD remained in the government. However, whether relations under the new conservative chancellor would not undergo significant changes, remained to be seen. Putin had offered his German counterpart an energy partnership that would cement the good energy relations that both countries had sustained to date. Instead, Angela Merkel proclaimed an energy alliance with France and insisted Russia signs the Energy Charter (see chapter 5).¹¹⁶

This move was troublesome, as it put the two main Western European partners of Russia on the side of the EU integrationist approach, especially at a moment of acrimonious anti-Russian campaign from the side of Poland, which went as far as portraying Nord Stream as a security threat outright.¹¹⁷ Besides this, the energy dispute between Russia and Belarus from January to February 2007, when oil supplies through Belarus were cut for two months, drew a clear condemnation from the side of the EU,¹¹⁸ whose new energy policy clearly warned against excessive dependency on single suppliers.¹¹⁹ Poland's more immediate worry was probably not as much security as economy-based: the construction of Nord

¹¹⁴ "К "severnomu potoku" mozhет prisoedinit'sia BP (К Северному потоку может присоединиться BP)", *RusEnergy*, 7 November 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹¹⁵ Trempel', Aleksandr: "Gasunie poluchila 9% v kapitale Nord Stream (Gasunie получила 9% в капитале Nord Stream)", *Moscow Times*, 23 June 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹¹⁶ "Gazprom - Germaniia: Okhlazhdenie posle peregreva (Газпром - германия: охлаждение после перегрева)", *Neft Rossii*, 12 December 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹¹⁷ "Polskii' energeticheskii' teatr (Польский энергетический театр)", *Neft Rossii*, 12 December 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University). Poland's qualms were best expressed in the ignominious formula coined by the Polish Minister of Defense and then of Foreign Affairs, Radislaw Sikorski, of the "Molotov-Ribbentrop" pipeline (Högselius, *op. cit.*, p. 216).

¹¹⁸ See: "Rossiia - ES: dvadtsat' sem' protiv odnogo (РОССИЯ - ЕС: ДВАДЦАТЬ СЕМЬ ПРОТИВ ОДНОГО)", *Neftgazavaia Vertikal'*, 28 February 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹¹⁹ Sherr, James: "Ugroza energeticheskoi' bezopasnosti: dolgozhdannii' otvet evropei'skogo soiuz (УГРОЗА ЭНЕРГЕТИЧЕСКОЙ БЕЗОПАСНОСТИ: ДОЛГОЖДАННЫЙ ОТВЕТ ЕВРОПЕЙСКОГО СОЮЗА)", *Zerkalo Nedeli*, 2 March 2007 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

Stream would definitely bury any prospects for Yamal-II.¹²⁰ Warsaw could not block Nord Stream as the pipeline would not cross its exclusive economic zone, while the EU had already earmarked Nord Stream as a project of strategic interest. However, the European Bank of Investments (EBI) announced that if Poland maintained its opposition, the institution could not provide any financial support to Nord Stream.¹²¹ This decision by the EBI (in the wake, by the way, of the European Bank of Reconstruction and Development's (EBRD) decision not to finance Sakhalin-II), threw doubts on the readiness of private investors to eventually step in,¹²² as it might have covered as much as 30% of the project's costs.¹²³ This happened amid doubts of the costs of Nord Stream, as the impression was that Gazprom was hiding the real costs of the project.¹²⁴

The rising costs of Nord Stream always lurked in the background and posed a significant threat. This for example, was the case when Gerhard Schroeder announced that, as opposed to €5bill, Nord Stream's total costs would amount to €8bill.¹²⁵ He specifically pointed to costs related to ecological adaptation,¹²⁶ even if some analysts were skeptical that the modifications demanded by the Baltic countries could really have such a big financial impact.¹²⁷ This was worrying news, as even if additional environment-related costs could not be blamed for these new figures, the fact was that the German BASF (partner through E.On) had recently talked of as much as €9bill. Soon more details transpired, which confirmed that instead of environmental issues, Gazprom's own assessments were to blame: the section to be built within Russian territory to the Baltic coast, jumped from US\$1.1bill. to US\$3bill.¹²⁸ Some even assessed that the whole project might amount to as much as US\$15bill.¹²⁹

However, Nord Stream boasted that in spite of Polish comments regarding the non-participation of the European Investment Bank (EIB), they would not need any investment from there, as the company

¹²⁰ Vodo, Vladimir and Grib, Natalia: "Protivniki SEG otsenili posledstviia proekta (Противники СЕГ оценили последствия проекта)", *Kommersant*, 13 February 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

¹²¹ "EIB ne smozhet finansirovat' Nord Stream (EIB не сможет финансировать Nord Stream)", *Vedomosti*, 10 January 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹²² Reznik, Irina: "Nord Stream vyshel iz doveriia (Nord Stream вышел из доверия)", *Gazeta*, 12 February 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹²³ Elder, Miriam: "Baltic Pipeline faces a minefield of problems", *The Moscow Times*, 15 February 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

¹²⁴ "Nord Stream vyshel", *op. cit.*

¹²⁵ Grivach, Alexei: "Dorogaia ekologiia (Дорогая экология)", *Vremia Novostei*, 12 December 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹²⁶ *Ibid.*

¹²⁷ "Gerhard Shreder podnial stoimost' Nord Stream na tret' (Герхард Шредер поднял стоимость Nord Stream на треть)", *RusEnergy*, 12 December 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹²⁸ Pavlovich, Dmitrii: "Nord Stream vyletaet v trubu (Nord Stream вылетает в трубу)", *Gazeta*, 9 January 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹²⁹ *Ibid.*

had already agreed all necessary financing in late 2007 with Société Générale, ABN Amro and Dresdner Kleinwort.¹³⁰ After this news, Gazprom announced that Nord Stream would cost €7,4bill. (US\$11,7bill.).¹³¹ Analyst Mikhail Korchemkin assessed this price as realistic.¹³² According to Gerhard Schroeder himself, this was related to ecological costs.¹³³ The ecological environmental argument was reiterated in June by the Financial Director of Nord Stream, Paul Corcoran.¹³⁴

The informal meeting in Riga, Latvia, in April 2007, in the context of the expiration of the EU-Russia Partnership and Cooperation Agreement, perfectly exemplified the competing poles in Europe, with Germany and Poland playing opposite roles in relation to Russia and holding different concepts of energy diversification in Europe: Poland wanted to raise again its opposition to Nord Stream and to actively lobby Nabucco instead.¹³⁵ Germany, from the other side, showed strong support to Gazprom's project, when its Minister of Economy, Michael Glos, stated that Nord Stream was not directed against anyone and was necessary if Europe wanted to cover its future demand of gas.¹³⁶ As the Russian ambassador to Germany stated in May, in the Conference "Energy Dialogue Russia-EU: Gas Aspects", in Berlin, "Poland vetoed Nord Stream fearing to lose gas transit".¹³⁷

In spite of the negative news from the "Baltic front" that ensued in late 2007 (see section below), Russia secured the support of Germany's Angela Merkel for Nord Stream, dispelling the fear that the end of Schröder's era would lead to worsened relations between Berlin and Moscow and confirming that the support by the German business partners was shared politically.¹³⁸ However, even from the German side, where Gazprom could be sure to receive due support, problems eventually happened and this because of

¹³⁰ "Finansiravaniie gazoprovoda Nord Stream idet po grafiku (Финансирование газопровода Nord Stream идет по графику)", *RusEnergy*, 7 March 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹³¹ "Nord Stream podorozhal do \$11,7 mlrd (Nord Stream подорожал до \$11,7 млрд)", *RusEnergy*, 31 March 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹³² "Pochem "severnii' potok" dlia "Gazproma"? (Почем "Северный поток" для Газпрома)", *RusEnergy*, 31 March 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹³³ "Gerkhard Schreder ob'iasnil, chem vyzvano udorozhaniie stroitel'stva Nord Stream (Герхард Шредер объяснил, чем вызвано удорожание строительства Nord Stream)", *RusEnergy*, 5 May 2008 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

¹³⁴ "Stoimost' Nord Stream vozrosla iz-za dopolnitel'nikh eko-issledovanii' (Стоимость Nord Stream возросла из-за дополнительных эко-исследований)", *RusEnergy*, 3 June 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹³⁵ Preobrazhenskii', Ivan and Kudashkina, Ekaterina: "Rizhkaia "vos'merka" (Рижская "восьмерка")", *Vedomosti*, 10 April 2007 (Accessed on the 8th April 2013, from Integrum, Helsinki University).

¹³⁶ "Germaniia pomozhet preodolet' somneniia otnositel'no Nord Stream (Германия поможет преодолеть сомнения относительно Nord Stream)", *RusEnergy*, 13 April 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹³⁷ Grib, Natal'ia: "Pravila igry (правила игры)", *Kommersant*, 30 May 2007 (Accessed on 21st February 2013, from Integrum, Helsinki University).

¹³⁸ Kolesnikov, Andrei': "Visbadenskii' dialog okazal'sia ochen' "Piterskim" (Висбаденский диалог оказался очень "Питерским")", *Kommersant*, 16 October 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

the German legislation; the problem that appeared in October 2007 did not relate to Nord Stream as such, but to the two secondary pipelines, OPAL and NEL, that were to connect Nord Stream's natural gas with the downstream markets:¹³⁹ the issue was that according to German legislation, every company should have access to pipelines within the German territory.¹⁴⁰ However, OPAL and NEL were supposed to be connected to Nord Stream, from where only Gazprom's gas would be received. Nord Stream thus needed an exception to be made to this legislation.

Given the staunch opposition by Poland, the Russian decision to suspend the embargo on Polish meat,¹⁴¹ could be seen as an attempt to reduce Warsaw's opposition to Nord Stream, and this may also be related to Donald Tusk's (Poland's Prime Minister) announcement that Poland was ready to consider Nord Stream in trilateral consultations between Germany, Russia and Poland.¹⁴² The Polish Prime Minister, in a state visit to Moscow in February 2008 was to reiterate its support for laying Nord Stream through Poland (as well as the rest of the Baltic Republics) instead of the Baltic Sea.¹⁴³ In this respect, Poland did not seem to be moving in favor of Russia's project. The fact that it signed together with other Baltic Republics a petition to suspend Nord Stream was in itself quite clarifying that the Baltic front as it had formed in the past year was far from disappearing.¹⁴⁴

In its relation to Germany, Nord Stream played another important role apart from the benefits it would bring to German energy companies: Nord Stream's demand for pipes for its construction represented an important boost for German steel producers.¹⁴⁵ For Gazprom was also positive that the European Union's summit confirmed that the new Energy Strategy, planned to come into force not later

¹³⁹ "Nord Stream tormoziat burokraty Germanii (Nord Stream тормозят бюрократы германии)", *Kommersant*, 21 October 2007 (Accessed on the 25th February 2013, from Integrum, Helsinki University).

¹⁴⁰ Kulikov, Sergei': "Nord Stream stolknulsia na posrednike (NORD STREAM СПОТКНУЛСЯ НА ПОСРЕДНИКЕ)", *Nezavisimaia Gazeta*, 25 October 2007 (Accessed on the 25th February 2013, from Integrum, Helsinki University).

¹⁴¹ Kulikov, Sergei': "Moskva soglasna sniat' embargo na postavki pol'skogo miasa (Москва согласна снять эмбарго на поставки польского мяса)", *Nezavisimaia Gazeta*, 13 December 2007 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

¹⁴² "Pol'sha gotova prismetret'sia k Nord Stream (Польша готова присмотреться к Nord Stream)", *Neftegaz.ru*, 12 December 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁴³ Kashin, Vasilii': "Nord Stream nashli zamenu (Nord Stream нашли замену)", *Vedomosti*, 29 January 2008 (Accessed on the 8th April 2013, from Integrum, Helsinki University).

¹⁴⁴ "Strany Baltii napisali petitsiiu protiv Nord Stream (Страны Балтии написали петицию против Nord Stream)", *RusEnergy*, 30 January 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁴⁵ Semenov, Ivan: "Osobyie truby dlia morskogo gazoprovoda (ОСОБЫЕ ТРУБЫ ДЛЯ МОРСКОГО ГАЗОПРОВОДА)", *Nezavisimaia Gazeta*, 11 March 2008 (Accessed on the 9th March 2013, from Integrum, Helsinki University). This was a repeat of energy projects made during the cold war, with German and Austrian industrial interests supportive of Soviet pipelines as a source of demand for their production (see: Högselius, *op. cit.*).

than 2010, would not affect Nord Stream.¹⁴⁶ The confirmation that Nord Stream remained a priority project of the EU was given in June 2008.¹⁴⁷

However, the war in Georgia once more led to a flurry of criticism against Russia and could have a potentially negative influence on Nord Stream if an anti-Gazprom front reinforced itself as a consequence. Gordon Brown's, UK Prime Minister, called for an end of the energy stranglehold of Europe by Russia,¹⁴⁸ which was significant of how easily the images of Russia as an hostile energy superpower were resurrected every time that Moscow's aggressive policy in the CIS space became manifest.

Nord Stream's goal: new resources or avoidance of transit countries

There existed arguments indeed in favor of the economic suitability of transporting natural gas through the Baltic instead of Belarus or Ukraine, but the clear economic rationale was to expand supply from Russia to feed future demand, expected to be higher. In this respect, the gas deposits in the Yamal peninsula represented the main argument Gazprom could put forward.¹⁴⁹ Gazprom was thus trapped between the danger of not being able to develop this resource base (as eventually happened) and the threat of over-supply in Europe if optimistic prospects of consumption proved unwarranted.

Following the declarations of Sergei' Emel'ianov, Vice-Head of GazExport, in September 2006, 22.3bcm of the initial supplies (the first pipeline would have a total capacity of 27.5bcm per year) were to be new gas, whereas the rest would represent volumes currently exported through Belarus and Ukraine.¹⁵⁰ In fact, from the first batch of gas to be sold when Nord Stream became operative, 5bcm to be transited

¹⁴⁶ Butrin, Dmitrii': "Evrosoiuz dal "Gazpromu" dva goda fory (Евросоюз дал Газпрому два года форы)", *Kommersant*, 15 March 2008 (Accessed on the 25th February 2013, from Integrum, Helsinki University).

¹⁴⁷ "ES prisvoil Nord Stream status prioritetnogo proekta (ЕС присвоил Nord Stream статус приоритетного проекта)", *RusEnergy*, 24 June 2008 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

¹⁴⁸ Medetskii', Anatolii': "Putin clinches deal for Uzbek pipeline", *The Moscow Times*, 3 September 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁴⁹ Gazprom initially intended to develop the Shtokman fields, off Murmansk in the Barents Sea. However, the prospective costs of the project scared banks which were to provide needed financial support for the project. This forced Gazprom to focus on the resources of the Yamal fields (see: Sapun, *op. cit.*). Alexei' Miller's declarations in October 2010 announcing that natural gas from the Shtokman fields would be redirected to Europe (through Nord Stream) instead of serving LNG to the US was somehow preposterous (see: "The Times: Medlennyi' rost dobychi - samoe uiazvimoe mesto "Gazproma" (The Times: Медленный рост добычи - самое уязвимое место "Газпрома")", *RusEnergy*, 10 October 2006 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁵⁰ Grivach, Alexei': "Ostatki "severnogo potoka" (Остатки "Северного потока")", *Vremia Novostei'*, 15 September 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

through these two countries were already planned to be exported through the Baltic Sea.¹⁵¹ This could however only happen if Yamal's resources were finally developed.

In addition to Yamal, the other candidate for supplying Nord Stream was the offshore field of Shtokman. In this respect, Gazprom had recently decided that instead of developing Shtokman in cooperation with foreign companies¹⁵² and to later export LNG to the US market, it would henceforth exploit it alone and reserve its natural gas for Germany through Nord Stream.¹⁵³ Gazprom was clearly promoting a strong energy partnership with Germany, an essential partner for the eventual success of Nord Stream. Shortly thereafter, Nord Stream AG presented on 14th November 2006 all needed documentation upon Russia, Finland, Sweden, Denmark and Germany, states through which territory the pipeline was planned to be laid down.¹⁵⁴ The German anti-monopoly office gave its consent on Nord Stream in December,¹⁵⁵ so the biggest hurdle remained to convince Scandinavian countries whose exclusive economic zones were necessary for the pipeline's transit.

Whether the Shtokman field could eventually feed Nord Stream or not, the fact is that resources in the Yamal Peninsula were necessary for its earlier stage.¹⁵⁶ In this respect, the warning from specialists in "Gasflot" (Gazprom's daughter company responsible for exploration) that development of fields in the Yamal Peninsula could hardly close up the deficit of declining fields in Western Siberia,¹⁵⁷ was problematic for Gazprom's projects. No less worrying was the announcement in April 2007, that supplies

¹⁵¹ *Ibid.*

¹⁵² In September 2005 Gazprom had short-listed the following candidates: Hydro and Statoil from Norway, the US Chevron and Conoco-Philips and The French Total (see: Reznik, Irina and Bekker, Alexandr: "Shtokman dlia russkikh (Штокман для русских)", *Vedomosti*, 10 October 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁵³ Grib, Natalia; Butrin, Dmitrii' and Vodo, Vladimir: "Germaniia prevyshe vsego (Германия превыше всего)", *Kommersant*, 10 October 2006 (Accessed on 21st February 2013, from Integrum, Helsinki University). Experts at the moment of this bombastic announcement already suspected what Gazprom would eventually have to do, namely, to delay the development of Shtokman, as Gazprom lacked the needed expertise to develop underwater resources (see: "Gazpromu" pridetsia otlozhit' razrabotku Shtokmanskogo mestorozhdeniia (Газпрому придется отложить разработку Штокмановского месторождения)", *Neftegaz.Ru*, 10 October 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁵⁴ "Nord Stream predstavil dokumenty o planiruемом gazoprovode Baltii'skoie More (Nord Stream представил документы о планируемом газопроводе Балтийское море)", *RusEnergy*, 14 November 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁵⁵ "Antimonopolnoe ведомство Germanii odobrilo sozдание kompanii-operatora Nord Stream (Антимонопольное ведомство Германии одобрило создание компании-оператора Nord Stream)", *RusEnergy*, 22 December 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁵⁶ Gazprom planned that gas from Shtokman could be transported at the earliest in 2014-2016 ("Gazprom" khochet podklyuchit' Shtokman k SEG v 2014-2016 ("Газпром" хочет подключить Штокман к СЕГ в 2014-2016 гг)", *RusEnergy*, 16 October 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University). For a detailed background on Shtokman, see: "Shtokman: pravilnyi' vybor ili blef? (Штокман правильный выбор или блеф)", *Neft Rossii*, 12 December 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁵⁷ Gavshina, Oksana: "Gazonosnaia guba (Газоносная губа)", *Gazeta*, 16 October 2006 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

from Shtokman would have to be delayed by three years, so they could only be available for 2013.¹⁵⁸ Even if Gazprom's announcement that half of supplies would be reserved for the pipeline (the other half for LNG)¹⁵⁹ sounded like a guarantee of the linkage between Shtokman and Nord Stream, this put the onus on natural gas from Yamal, which would have to ensure at least the first stages. Soon Gazprom backtracked from its announcement of developing Shtokman without foreign help, announcing that the first part would be developed with the French Total.¹⁶⁰

Gazprom calculated that natural gas from Yamal could be ready by 2011,¹⁶¹ that is, one year before the second spur of Nord Stream was supposed to be operative. The fact is that in December 2007, an important agreement was struck between Gazprom and BASF to give the latter, in exchange for shares in Germany's downstream sector, access for the development of the "Yuzhno-Russkoe" field in the peninsula of Yamal.¹⁶² Cashing in on the occasion that Russian-Polish relations were timidly improving by early 2008 (the Russian embargo on Polish meat was lifted), Sergey Lavrov assured Poland that the construction of Nord Stream would not provoke a lessened transit through the Yamal pipeline.¹⁶³ This seemed to be a hint that Nord Stream was to mobilize new resources. Would Ukraine also be as lucky and not lose any volumes transiting the country?

By the end of 2008, before the January 2009 energy war started (see chapter 8), doubts remained concerning the development of the resources from Shtokman, which were initially poised to become the main source for Nord Stream. The problem laid in the fact that without tax breaks, the management of the consortium Shtokman Development AG considered it would be uneconomical to exploit the field.¹⁶⁴ The consortium was thus asking the state to assume some of the costs by waiving taxes from the imports of necessary technical equipment. As far as the Nord Stream was concerned, this did not pose any

¹⁵⁸ "Nachalo postavok SPG Shtokmana otlozhenno na tri goda (Начало поставок СПГ Штокмана отложено на три года)", *Vedomosti*, 5 April 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁵⁹ "Polovina gaza so Shtokmana uidet v trubu (Половина газа со Штокмана уйдет в трубу)", *Kommersant*, 5 April 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University). This was accompanied by the announcement of approval for the eventual construction of a second spur for Nord Stream (see: "SEGu udvoili proizvoditel'nost' (СЕГу удвоили производительность)", *Neftegaz.Ru*, 5 April 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁶⁰ "'Gazprom' i Total zapustili pervuiu fazu Shtokmana ('Газпром' и Total запустили первую фазу Штокмана)", *RusEnergy*, 16 July 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁶¹ Medetskii', Anatolii': "Gazprom looks to pump up volume", *The Moscow Times*, 15 June 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

¹⁶² Reznik, Irina: "Napolnitel' dlia Nord Stream (Наполнитель для Nord Stream)", *Gazeta*, 19 December 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁶³ "Zapusk gozoprovoda Nord Stream ne privedet k sokrasheniiu obemov tranzita gaza cherez Pol'shu (не приведет к сокращению объемов транзита газа через Польшу)", *RusEnergy*, 21 January 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁶⁴ Grib, Natal'ia: "Shtokman perenosiat v ofshornuiu zonu (Штокман переносят в офшорную зону)", *Kommersant*, 10 December 2008 (Accessed on the 26th February 2013, from Integrum, Helsinki University).

immediate obstacle regarding the first stage, which would extract its resources from Yamal. However, the second spur needed Shtokman's natural gas from it if Nord Stream wanted to ensure full capacity.¹⁶⁵

Ecological Issues enter the Turf and Nord Stream faces opposition among Baltic countries

Ecology started playing an important role in the prospects of the Baltic route already by late 2006, when Nord Stream was just taking off and when Swedish Prime Minister, Göran Persson, pointed to the dangers the new pipeline might represent for the Baltic ecosystem.¹⁶⁶ The victory of conservatives that same year in Sweden and their worse predisposition towards Russia¹⁶⁷ was a bad omen for Nord Stream. Unfortunately for Russia, another delicate issue was that the submarine ground would have to be cleared of mines and bombs from World War II to guarantee the route's security. Experts in the new Swedish government issued a harsh report on Nord Stream, stating that Sweden would extract no benefits from it, while the project was harmful for the country. According to the report, Sweden would demand at least that the technical platforms should not be close to its border,¹⁶⁸ catering to general fear of negative ecological consequences and Russian espionage.¹⁶⁹

Along with Sweden, Finland soon became one of the most outspoken Baltic countries to voice similar concerns. In February 2007, Finland publicly demanded a detailed route of the pipeline through the Baltic Sea, in order to assess its potential environmental impact.¹⁷⁰ The mood that seemed to be consolidating in Finland veered towards demanding that Nord Stream crosses Estonia's territory instead of that of Finland.¹⁷¹ This was particularly dangerous for Gazprom for obvious reasons: leaving the fate of Nord Stream in the hands of one of the Baltic Republics, Estonia, which belonged to the group of countries staunchly opposed to Russia's energy projects, was a guarantee for Nord Stream to remain still-born; the veto by Estonia, in April 2007, when Gazprom requested its permission to conduct feasibility

¹⁶⁵ *Ibid.*

¹⁶⁶ "Shvedskie tai'ny utekut v Rossiiu po gazoprovodu (Шведские тайны утекут в Россию по газопроводу)", *RusEnergy*, 17 November 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁶⁷ Beyond the merely ecological issue, the fact is that opposition to Nord Stream also entered the security realm, reviving the usual fear of a neo-Soviet Russia; Nord Stream was thus decried by the Swedish opposition as a possible inlet for Russian intelligence (see: Grivach, "Severnyi' potok", *op. cit.*).

¹⁶⁸ "Pravitel'stvo Shvetsii nedovol'no SEGom (правительство Швеции недовольно СЕГом)", *Kommersant*, 11 December 2006 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

¹⁶⁹ Sergeev, Mikhail: "Shvedy khotiat povernut' vspiat' Nord Stream (ШВЕДЫ ХОТЯТ ПОВЕРНУТЬ ВСПЯТЬ NORD STREAM)", *Nezavisimaia Gazeta*, 11 December 2006 (Accessed on the 26th February 2013, from Integrum, Helsinki University).

¹⁷⁰ "Finlandiia trebuat bolee detal'noi' otsenki marshruta prokladki SEG (Финляндия требует более детальной оценки маршрута прокладки СЕГ)", *RusEnergy*, 27 February 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁷¹ Grivach, Alexei': "Politicheskoe dno (Политическое дно)", *Vremia Novostei'*, 28 February 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

studies in its maritime space, was a reminder of the consequences of depending on Tallin.¹⁷² The refusal one month later, from the side of Estonia's Prime Minister, Andrus Ansip, to meet Gerhard Schroeder, in representation of Nord Stream, represented another cold shower.¹⁷³ When Gazprom submitted a second request of permission, Estonia answered that they would carry out their own assessment.¹⁷⁴ Worse, Estonian President Toomas Ilves announced in a clear provocation, that they had three years to conduct the assessment.¹⁷⁵ These worries represented a particular challenge for Russia, as the problem could not be circumscribed only to Sweden and Finland. By its nature and by the potential ecological threat to the whole Baltic Sea, all riparian states demanded a environmental impact assessment (EIA).¹⁷⁶ If Finland had proposed to use Estonian maritime territory instead, Lithuania now publicly proposed to build an alternative by land.¹⁷⁷

It is true that by April 2007, Russia could count on better news from the "Baltic front", as Latvia no longer opposed Nord Stream, with its Prime Minister, Aigars Kalvitis, stating he trusted the company to find a suitable solution to ecological issues and considered the project from a strictly commercial point of view.¹⁷⁸ However, Gazprom could not count on any stable improvement (if there was any improvement at all), as one month later, Lithuania and Latvia were both proposing an alternative to Nord Stream, consisting of a Baltic pipeline crossing through their territory and Poland.¹⁷⁹ This somber panorama seemed to improve when Finland granted permission to Gazprom to conduct studies within its maritime area, as initially considered.¹⁸⁰ This finally opened for Gazprom a way out of Estonia's intransigent position. At the same time, however, bad news kept piling up:

¹⁷² Grivach, Alexei': "Duiut na vodu", *Vremia Novostei'*, 16 April 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁷³ "Estoniia ne khochet obsuzhdat' s Germaniei' proekt SEG (Эстония не хочет обсуждать с Германией проект СЕГ)", *RusEnergy*, 7 May 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁷⁴ "Estoniia tormozit Nord Stream (Эстония тормозит Nord Stream)", *Gazeta*, 29 June 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁷⁵ *Ibid.*

¹⁷⁶ Elder, *op. cit.*

¹⁷⁷ "Litva prosit izmenit' marshrut gazoprovoda Nord Stream (Литва просит изменить маршрут газопровода Nord Stream)", *RusEnergy*, 21 February 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁷⁸ With Latvia trying to offer its position as a potential host for storage facilities to ensure Nord Stream's steady flow, there were probably reasons for this more favorable stance (see: "Latviia ne vozrazhaet protiv proekta "Severnyi' potok" (Латвия не возражает против проекта "Северный поток")", *RusEnergy*, 24 April 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁷⁹ "Latvia i Litva predlagaiut prokladyvat' SEG cherez svoi territorii (Латвия и Литва предлагают прокладывать СЕГ через свои территории)", *RusEnergy*, 29 May 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁸⁰ "Pravitel'stvo Finliandii razreshilo kompanii Nord Stream issledovat' morskoe dno v finskoi' chasti Baltiki (Правительство Финляндии разрешило компании Nord Stream исследовать морское дно в финской части Балтики)", *RusEnergy*, 15 June 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

The European Commission, moving forward in its plans for deepening the EU's common energy policy and working on the future 3rd Energy Package (approved in 2009), decried Gazprom's monopolistic position in many countries in the EU, and pointed to Nord Stream: Gazprom might have to reduce its stake (51%) in the projected pipeline.¹⁸¹ If that was not enough, Nord Stream stumbled in July 2007 against Denmark and Poland regarding a stretch earmarked for the project, as the area was disputed by both countries.¹⁸² The area, south of the island of Bornholm, was affected by explosives from World War II, so Gazprom decided to agree with Sweden to lay the pipeline through another route north of the island, and only within Sweden's maritime area.¹⁸³ This implied that additional difficulties might appear with Sweden, but at least Poland would no longer have any possibility to block the project.¹⁸⁴ During the summer 2007, the Baltic countries and Poland struck and demanded that the EU Commission should force Gazprom to modify the course of the pipeline so Nord Stream crosses the Baltic Republics and Poland instead. These countries were thus reviving the project "Amber", proposed by Gazprom back in the 90s, and subsequently rejected.¹⁸⁵ In August 2007, participants in a conference taking place in Tallinn and devoted to Nord Stream, called to exert pressure on Germany to oppose Nord Stream.¹⁸⁶ Poland, after it had lost any chance to block Nord Stream by reviving its territorial conflict with Denmark, tried to influence other countries, demanding a new assessments of environmental impact.¹⁸⁷

News in the next months remained quite somber for Nord Stream. The Estonian press revealed that one of the reasons for Nord Stream AG's agreeing to consider the Estonian route was the negative assessment allegedly given from Finland in 2006.¹⁸⁸ However, the Estonian side seemed to remain opposed to Nord Stream's construction in its territorial waters. Even if there had been news that the

¹⁸¹ Kulikov, Sergei: "Evropa vykruchivaet ruki "Gazpromu" (Европа выкручивает руки "Газпрому")", *Nezavisimaya Gazeta*, 18 June 2007 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

¹⁸² "New twists and turns in plan for German-Russian pipeline", *Oil and Gas Europe*, 16 July 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

¹⁸³ "Kommersant": za izmeneniem marshruta SEG stoit politicheskii konflikt Rossii i Pol'shi ("Коммерсант": За изменением маршрута СЕГ стоит политический конфликт России и Польши)", *RusEnergy*, 22 August 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁸⁴ Grivach, Alexei: "Mimo Pol'shi (Мимо Польши)", *Vremia Novostei*, 22 August 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁸⁵ Grivach, Alexei: "Iantarnoe pomishatel'stvo (Янтарное помешательство)", *Vremia Novostei*, 25 July 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁸⁶ "Estoniia": strany Evrosoiuza dolzhny okazat' davlenie na Germaniiu, chtoby ona otkazalas' ot stroitel'stva SEG ("Эстония": Страны Евросоюза должны оказать давление на Германию, чтобы она отказалась от строительства СЕГ)", *RusEnergy*, 20 August 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁸⁷ Vodo, Vladimir and Grib, Natal'ia: "Pol'sha trebuetsya povtornoï ekologicheskoi ekspertizy gazoprovoda (Польша требует повторной экологической экспертизы СЕГ)", *Kommersant*, 27 August 2007 (Accessed on 21st February 2013, from Integrum, Helsinki University).

¹⁸⁸ "Finny zaiavili o vosmozhnom negativom vliianii SEG na okruzhaiushchuiu sredu (Финны заявили о возможном негативном влиянии СЕГ на окружающую среду)", *RusEnergy*, 19 September 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

country was ready to approve the pipeline,¹⁸⁹ Estonia kept postponing its final decision.¹⁹⁰ The next week, Urmas Paet, Minister of Foreign Affairs of Estonia, stated that the decision would be negative, as it had been in fact decided a long time ago.¹⁹¹ Some days later, the final rejection to Nord Stream's intention to conduct assessments in the Estonian territorial waters was confirmed, in what was a hard blow to Gazprom.¹⁹² In exchange, Estonia revived the option, loathed by Gazprom, of laying the new pipeline on land.¹⁹³ Estonia did not show any sign of relenting in its acrimonious opposition to the pipeline, even calling the European Commission and every country in the Baltic region, to form a common front against Nord Stream.¹⁹⁴ This information, which appeared in the Finnish press, was denied by the Estonian Ministry of Foreign Affairs.¹⁹⁵ However, no sign of improvement could be found. This left Finland as the only possible route for Nord Stream.

While the blockade with Estonia persisted, difficulties appeared from the side of Sweden: Sweden's Ministry of Environment expressed disappointment at the fact that Gazprom had failed to present yet an assessment of environmental impact as well as alternative routes for Nord Stream.¹⁹⁶ Sweden's intention was simply to reroute the pipeline to a more environment-friendly area.¹⁹⁷ As could have been expected, the difficulties the Baltic countries were putting forward against the project were sooner or later to affect the timetable of Nord Stream. At least that was the reason put forward by the technical director of Nord Stream AG, Sergei Serdiukov, who stated that the construction of the pipeline would start in mid-2009 that is, half a year later than foreseen.¹⁹⁸ From Finland there were doubts that

¹⁸⁹ Gavshina, Oksana: "Severo-evropeiskii gazprovod pustiat v estonskii sektor Baltiki (северо-европейский газопровод пустят в эстонский сектор балтики)", 13 September 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁹⁰ "Estoniia пока ne priniala reshenie ob issledovanii morskogo dna v estonskoi ekonomicheskoi zone (Эстония пока не приняла решение об исследовании морского дна в эстонской экономической зоне)", *RusEnergy*, 13 September 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁹¹ "Estoniia zapretit SEG? (Эстония запретит СЕГ?)", *RusEnergy*, 19 September 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁹² Gavshina, Oksana: "Estoniia skazala 'net' (Эстония сказала 'нет')", *Gazeta*, 21 September 2007.

¹⁹³ "Estoniia vystupila za nazemnyi variant provedeniia Nord Stream (Эстония выступила за наземный вариант проведения Nord Stream)", *RusEnergy*, 4 October 2007 (Accessed on the 9th April 2013, from Integrum, Helsinki University).

¹⁹⁴ Syi'r, Beniamin: "No-Pasaran po-estonski (No-Pasaran по-эстонски)", *Gazeta*, 30 October 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

¹⁹⁵ "MID Estoniia: my ne rassypali pis'mo s pryzvom izmenit' marshrut prokladki gazoprovoda Nord Stream (МИД Эстонии: Мы не рассылали письмо с призывом изменить маршрут прокладки газопровода Nord Stream)", *RusEnergy*, 31 October 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

¹⁹⁶ Dempsey, Judy: "Sweden raises a new hurdle for German-Russian pipeline", *International Herald Tribune*, 6 November 2007 (Accessed on the 26th April 2013, from Integrum, Helsinki University).

¹⁹⁷ "Shvetsiia izmenit napravlenie gazoprovoda Nord Stream (ШВЕЦИЯ ИЗМЕНИТ НАПРАВЛЕНИЕ ГАЗОПРОВОДА NORD STREAM)", *Nezavisimaia Gazeta*, 8 November 2007 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

¹⁹⁸ "Estoniia poluchit za Nord Stream kruglen' kuiu summu? (Эстония получит за Nord Stream кругленькую сумму?)", *RusEnergy*, 8 November 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

even this timetable was unrealistic, as they considered that the report on environmental impact by Nord Stream could not be ready before April 2008.¹⁹⁹

In the face of the Swedish objections, Nord Stream announced the route would be changed to less ecologically sensitive areas.²⁰⁰ However, Finland stated that the course planned around the Swedish island of Gotland in its territorial waters (as the Estonian alternative remained closed) should be changed, as it would go through waters with poisonous deposits which might be extended because of the construction of Nord Stream.²⁰¹ Among this flurry of disappointments for Gazprom and for all partners in Nord Stream, there was at least a good sign from the European Commission. In spite of being in the midst of preparing a new stage in the EU's energy policy and despite negative omens regarding how new anti-monopoly legislation might eventually affect Nord Stream, the European Commission announced that the future pipeline, as a trans-boundary project, would not be affected by any changes in such direction.²⁰² The Energy Commissar, Andris Piebalgs, reiterated the Commission's support to Nord Stream in January 2008.²⁰³

The situation in 2008 remained quite delicate for Gazprom, given that Finland remained opposed, especially since news regarding hazards related to the route north of Gotland had transpired and Finland feared that the country might be affected in case of accident. Finland at the same time persisted in demanding that the pipeline was not to be laid through its territorial waters.²⁰⁴ Finland's insistence could eventually lead to Nord Stream's end, as we already saw how inflexible Estonia's position was. Sweden at the same time was also increasing its opposition, worried now that the route chosen by Nord Stream went through an area of high maritime traffic.²⁰⁵ By February, Sweden demanded more details from Nord

¹⁹⁹ "Finlandiia ne verit v skorosti Nord Stream (Финляндия не верит в скорости Nord Stream)", *Vedomosti*, 9 November 2007 (Accessed on the 8th April 2013, from Integrum, Helsinki University).

²⁰⁰ "Nord Stream meniaet napravlenie? (Nord Stream меняет направление?)", *RusEnergy*, 13 November 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

²⁰¹ Chai'ka, Fedor: "Vsdornomu sosedu i kadmii' mechaet (Вздорному соседу и кадмий мешает)", *Izvestiia*, 14 November 2007 (Accessed on the 8th April 2013, from Integrum, Helsinki University).

²⁰² Butrin, Dmitrii': "ES ne otverg energoreformu s khodu (ЕС не отверг энергореформу с ходу)", *Kommersant*, 22 September 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

²⁰³ "Evrokomissar po voprosam energetiki vystupil v zashchitu proekta Nord Stream (Еврокомиссар по вопросам энергетики выступил в защиту проекта Nord Stream)", *RusEnergy*, 30 January 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

²⁰⁴ "Finlandiia rekomendavala Nord Stream issledovat' alternativnyi' marshrut gazoprovoda, ne prokhodiashchii' cherez ee vodu (Финляндия рекомендовала Nord Stream исследовать альтернативный маршрут газопровода, не проходящий через ее воды)", *RusEnergy*, 22 January 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

²⁰⁵ Kulikov, Sergei': "Soglasavaniie marshruta gazoprovoda Nord Stream prevrashchaetsia dlia Rossii v nastoiashchee ispytaniie (Согласование маршрута газопровода Nord Stream превращается для России в настоящее испытание)", *Nezavisimaia Gazeta*, 22 January 2008 (Accessed on the 19th February 2013, from Integrum, Helsinki University).

Stream in order to make its final assessment, as it remained dissatisfied with the information provided so far.²⁰⁶

The environmental issue was important enough to attract the attention of the European Commission, which decided to assess the environmental impact of Nord Stream and to pronounce itself regarding the matter.²⁰⁷ In May, the EU Parliament declared that Nord Stream could imperil the ecosystem of the Baltic Sea and therefore, deemed that an independent expertise of the project had to be undertaken.²⁰⁸ However, difficulties from the side of the Scandinavian countries were the (at least apparent) motive for Nord Stream to delay the start of the pipeline to mid-2011 from early 2011.²⁰⁹ It was later suggested that Germany could receive natural gas from the pipeline at the earliest in 2012.²¹⁰ Nord Stream announced that the first spur of the pipeline could be ready by October 2011 if all ecological issues were solved by 2009 and construction allowed through the route proposed.²¹¹

In September 2008, Nord Stream announced it would go back to the South of the Island of Bornholm, as initially planned, but choosing a new route that avoided any area imperiled by weapon deposits.²¹² From the side of Finland, a meeting between Finnish Prime Minister Matti Vanhanen and his now Russian counterpart, Vladimir Putin, led to Finland's promise to speed up the process of assessing the feasibility of the pipeline's construction through Finland's territorial waters.²¹³ On the eve of the energy dispute of January 2009, Nord Stream remained blocked in its main front, the Scandinavian one: Finland announced that it would not pronounce on Nord Stream until March 2009.²¹⁴

²⁰⁶ "Shvetsiia prosit informatsionnoi "dobavki" (Швеция просит информационной "добавки")", *Neftegaz.ru*, 13 February 2008 (Accessed on the 18th February 2013, from Integrum, Helsinki University).

²⁰⁷ "ES proverit ekologichnost' "Severnogo Potoka" (ЕС проверит экологичность "Северного потока")", *RusEnergy*, 30 January 2008 (Accessed on the 19th February 2013, from Integrum, Helsinki University).

²⁰⁸ Kashin, Vasilii': "Snova khartiia (Снова хартия)", *Vedomosti*, 28 May 2008 (Accessed on the 8th March 2013, from Integrum, Helsinki University).

²⁰⁹ "Zapusk Nord Stream otkladyvaetsia (Запуск Nord Stream откладывается)", *Vedomosti*, 10 July 2008 (Accessed on the 8th April 2013, from Integrum, Helsinki University).

²¹⁰ "Novyi' srok Nord Stream (Новый срок Nord Stream)", *Vedomosti*, 24 July 2008 (Accessed on the 8th April 2013, from Integrum, Helsinki University).

²¹¹ "Novyi' srok (Новый срок)", *Vedomosti*, 19 November 2008 (Accessed on the 8th April 2013, from Integrum, Helsinki University).

²¹² "Nord Stream AG vtorichno izmenila marshrut prokladki gazoprovoda v baltii'skom more (Nord Stream AG вторично изменила маршрут прокладки газопровода в Балтийском море)", *RusEnergy*, 4 September 2008 (Accessed on the 22th April 2013, from Integrum, Helsinki University).

²¹³ Naumov, Igor': "Vladimir Putin i Matti Vankhanen dogovorilis' po Nord Stream i poshlinam na les (Владимир Путин и Матти Ванханен договорились по Nord Stream и пошлинам на лес)", *Nezavisimaia Gazeta*, 13 November 2008 (Accessed on the 8th April 2013, from Integrum, Helsinki University).

²¹⁴ Grib, Natal'ia: "Finny zamorozili Nord Stream do vesny (Финны заморозили Nord Stream до весны)", *Kommersant*, 18 December 2008 (Accessed on 26th February 2013, from Integrum, Helsinki University).

South Stream

Compared to Nord Stream and Nabucco, South Stream was a late-comer. Before its conceptualization in 2007, Gazprom tentatively explored other alternatives which soon petered out: There were talks in June with Slovenia to transport Russian gas to Italy,²¹⁵ and with Hungary to link up with the Blue Stream (Russia-Turkey).²¹⁶ This latest offer was the first predecessor of South Stream, even if the agreement signed between Gazprom and the Hungarian MOL did not push Hungary to leave Nabucco, as Budapest preferred to play on both sides.²¹⁷ Similar was the situation with Serbia, interested in Gazprom's extension of Blue Stream through the Balkans (even if Gazprom had to put a brake on Belgrade's enthusiasm).²¹⁸ Facing Hungary's ambiguous and opportunistic stance and Serbia's enthusiasm, Rumania and Bulgaria remained staunch supporters of Nabucco.²¹⁹

A few months after these developments, Gazprom signed with the Hungarian MOL a more concrete agreement to establish a joint venture for the construction of the "South-European Pipeline",²²⁰ in what was already a clear conceptualization of the future South Stream. Along with this, Gazprom planned to sign a landmark agreement with the Italian ENI for the construction of Blue Stream II and for supplying 5bcm to Italy through the new route.²²¹ The interesting element in this project is that two routes were considered: either through Greece to Italy, or through Central Europe, servicing Bulgaria, Rumania, Hungary, Austria and retaining the option of still supplying Italy.²²² This latter option poised this project as the clear competitor of Nabucco.

However, at this stage, laying out Blue Stream II would add only 6bcm²²³ to the existing total capacity of 16bcm of Blue Stream, to which at least half was already contracted to Turkey; compared to Nabucco, Gazprom's project did not seem to be a serious competitor. In addition to this, Gazprom seemed

²¹⁵ Grivach, Alexei': "Slovenskii' Platsdarm (Словенский плацдарм)", *Vremia Novostei'*, 15 June 2006 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²¹⁶ Dempsey, Judey: "Gazprom's grip on Western Europe tightens with pipelines to Hungary", *International Herald Tribune*, 22 June 2006 (Accessed on the 26th April 2013, from Integrum, Helsinki University).

²¹⁷ Grivach, Alexei': "Uteret' nos Nabucco (Утереть нос Nabucco)", *Vremia Novostei'*, 22 June 2006 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²¹⁸ Grivach, Alexei': "Strashnee krasnoi' armii (Страшнее Красной армии)", *Vremia Novostei'*, 3 August 2006 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²¹⁹ *Ibid.*; Grivach, Alexei': "Peregovory bez udavol'stviia (Переговоры без удовольствия)", *Vremia Novostei'*, 26 July 2006 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²²⁰ "Vengriia khochet stat' gazovym perekrestkom Evropi (Венгрия хочет стать газовым перекрестком Европы)", *Gazeta*, 21 September 2006 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²²¹ Grib, Natalia: "Gazprom razvodit potoki (Газпром разводит потоки)", *Kommersant*, 21 September 2006 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

²²² *Ibid.*

²²³ *Ibid.*

to be overambitious, as it also planned that Blue Stream would branch out not only towards Europe, but to Israel too.²²⁴

Despite the reasonable doubts that could be held as to Blue Stream's extension prospects, by 2007 Gazprom seemed to be able at least to maintain alive chances for its new alternative, in clear competition with Nabucco, due to Hungary's continued ambiguity: Hungary's prime minister, Ferenc Gyurcsany, stated that Nabucco, though welcome, was not realistic enough.²²⁵ Some days later, in a new variation, he simply stated that Hungary could perfectly split supplies and receive half from each of the two alternatives.²²⁶ MOL was supposed to take a final decision by July.²²⁷ Meanwhile, in its already usual play of (probably intended) inconsistency, the Prime Minister came out decrying Hungary's dependency on Russia's gas.²²⁸ By December, Hungary persisted in its ambiguity, calling for the creation of an energy consortium with Slovenia, Croatia, Bosnia-Herzegovina, Serbia, Rumania, Bulgaria and Austria in order to ease obtaining credits for Nabucco,²²⁹ and to reinforce Nabucco's negotiating position.²³⁰

Then came in May the news that a new important partner might be on board for Gazprom's projects of diversification: Bulgaria. In a meeting between Alexei Miller and Bulgaria's Minister of Economy, Rumen Ovcharov, there was talk of increasing energy cooperation between Russia and Bulgaria. It was suspected that among all topics discussed, the possibilities opened by Blue Stream II were considered.²³¹ Equally positive signs came from Greece, which proposed Gazprom to build a gas pipeline along the projected oil pipeline Bourgas (Bulgaria)-Alexandroupolis (Greece), thus reinforcing Gazprom's presence in markets which were potential customers of Nabucco.²³²

²²⁴ Grib, Natalia: "Gazprom" peresechet Turtsiiu ("Газпром" пересечет Турцию)", *Kommersant*, 30 October 2006 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

²²⁵ Dempsey, Judy: "Hungary chooses Gazprom over EU", *International Herald Tribune*, 12 March 2007 (Accessed on the 26th April 2013, from Integrum, Helsinki University).

²²⁶ Smolchenko, Anna: "Hungary Hints at Using 2 Pipelines", *The Moscow Times*, 23 March 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

²²⁷ "MOL to Decide Over Nabucco, Blue Stream Deal In July", *Oil and Gas Eurasia*, 23 March 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²²⁸ Gavshina, Oksana: "Vengerskii razvorot (Венгерский разворот)", *Gazeta*, 23 April 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²²⁹ Grib, Natal'ia and Khvostik, Evgenii: "Vengriia schivaet gazovye seti (Венгрия сшивает газовые сети)", *Kommersant*, 6 December 2007 (Accessed on the 25th February 2013, from Integrum, Helsinki University).

²³⁰ "Geopoliticheskaia igra vokrug iugo-vostochnogo marshruta postavok gaza v Evropu obostrilas' (Геополитическая игра вокруг юго-восточного маршрута поставок газа в Европу обострилась)", *RusEnergy*, 6 December 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

²³¹ Gavshina, Oksana: "Gazprom uskorit stroitel'stvo "golubogo potoka" 2 (ГАЗПРОМ УСКОРИТ СТРОИТЕЛЬСТВО "ГОЛУБОГО ПОТОКА" 2)", *Gazeta*, 8 May 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²³² Medetskii, Anatolii: "Gazprom welcomes Greek pipe idea", *The Moscow Times*, 4 June 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

The birth of South Stream

This project of diversification, which competed with Nabucco, gave a leap forward when Putin travelled to the Balkans (to the Energy Summit of Southeast European Countries, in Zagreb, Croatia) to confer with a series of countries in the region (Slovenia, Bosnia-Herzegovina, Montenegro, Macedonia, Serbia, Albania, Greece, Bulgaria and Romania).²³³ One day before the conference, President Vladimir Putin announced the creation of "South Stream": Gazprom signed with the Italian ENI a project to lay an underwater pipeline in the Black Sea which would link Russia to Bulgaria.²³⁴ From there, South Stream would branch out in two directions: to Austria and Slovenia and then to Southern Italy;²³⁵ the planned capacity was almost the same as that of Nabucco: 30bcm per year.²³⁶ Leaving Turkey out of this project and avoiding the prominence Ankara would have assumed in the event that Blue Stream had been expanded, made sense if Russia wanted to prevent excessive power from the part of a single country, which by the way, as was pointed out at the moment, had close relations to the US and had also easy access to other competing producers, such as Azerbaijan and Iran.²³⁷

Gazprom tried to take a big step forward when it invited another key country into South Stream: Austria.²³⁸ This was also a very symbolic move, as the Austrian ÖMV was the main promoter of South Stream's rival, Nabucco. In the meantime, Bulgaria seemed to be eagerly supporting South Stream, as when Kazakhstan expressed its interest in the pipeline during a visit by the Bulgarian Minister of Foreign Affairs, Ivailo Kalfin.²³⁹ In fact, in early November 2007, the Ministers of Energy of Russia and Bulgaria, Viktor Khristenko and Petar Dimitrov met and manifested their support to South Stream.²⁴⁰

²³³ Medetskii', Anatolii': "President to talk energy in Balkans", *The Moscow Times*, 22 June 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

²³⁴ "Gazprom and Eni plan European pipeline", *International Herald Tribune*, 24 June 2007 (Accessed on the 26th April 2013, from Integrum, Helsinki University).

²³⁵ *Ibid.*

²³⁶ *Ibid.*

²³⁷ Grib, Natal'ia: "Gazoprovod Iuzhnyi' potok prodolzhat v Chernom more mimo Turtsii (Газопровод Южный поток проложат в Черном море мимо Турции)", *Kommersant*, 25 June 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

²³⁸ "Avstriia vliivaetsia v "Iuzhnyi' Potok" (Австрия вливается в "Южный поток")", *Neftegaz.ru*, 17 August 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²³⁹ "Kazakhstan proshchupivaet pochvu pod truboprovodom "Iuzhnyi' potok" (Казахстан прошупывает почву под трубопроводом "Южный поток")", *Neftegaz.ru*, 4 September 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁴⁰ "Ministry energetiki Rossii i Bolgarii vnesut predlozhenie o zakliuchenii soglasheniia po proektu "Iuzhnyi' Potok" (Министры энергетики России и Болгарии внесут предложение о заключении соглашения по проекту "Южный поток")", *RusEnergy*, 9 November 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

Some days later, Russia announced its intention to build South Stream from Russia to Bulgaria.²⁴¹ This did not prevent Bulgaria from keeping at the same time lobbying for Nabucco in Azerbaijan, as Bulgaria was also partner of Nabucco.²⁴² Soon after this, Gazprom was also moving forward with its Italian partner, ENI, signing an agreement to commission marketing and technical feasibility studies of the project.²⁴³

Into 2008, trying to attract a new partner, Vladimir Putin welcomed Greece's intention of doubling its imports of Russian natural gas and stated that this goal could be reached only if capacity was increased with the construction of South Stream.²⁴⁴ In January an important move forward for South Stream was planned, as Putin expected in his visit to Bulgaria to sign an agreement on the pipeline's construction.²⁴⁵ Bulgaria was as essential an eventual transit country, as a difficult partner. This became manifest when Sofia started criticizing the expected agreement.²⁴⁶ It was suspected that it might be playing a double game, the same way Hungary had been doing the last year, seeing South Stream merely as an insurance in case Nabucco finally did not materialize.²⁴⁷ Sofia demanded 51% in the new company that would build the Bulgarian section of South Stream.²⁴⁸ In the agreement finally signed, Bulgaria accepted a 50% stake.²⁴⁹ In parallel, Gazprom and ENI registered a company in Switzerland to implement the undertaking of the pipeline's construction.²⁵⁰ There was an interesting detail in the agreement signed, as it foresaw the capacity the pipeline would have: 30bcm per year.²⁵¹ Again, close to what Nabucco would transport.

January 2008 still reserved some more positive news for Gazprom, who seemed to be consolidating South Stream through the addition of new partners. This was the case with Serbia, another

²⁴¹ "Gazprom" ob'javil o namerenii postroit' eshche odin morskoi' gazprovod v Evropu - "Iuzhnyi' Potok" (Газпром объявил о намерении построить еще один морской газопровод в Европу - "Южный поток"), *RusEnergy*, 14 November 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

²⁴² Mamedov, Sokhbet: "Sofiia v Baku lobbiрует proekt Nabucco (СОФИЯ В БАКУ ЛОББИРУЕТ ПРОЕКТ NABUCCO)", *Nezavisimaia Gazeta*, 14 November 2007 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

²⁴³ "Eni and Gazprom Reinforced South Stream Project by Further Agreement", *Oil and Gas Eurasia*, 22 November 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁴⁴ Smolchenko, Anna: "Putin says gas to Greece will double", *The Moscow Times*, 19 December 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

²⁴⁵ Kesik, Irina: "'Iuzhnyi' potok" grozit zasokhnut' v Bolgarii ("Южный поток" грозит засохнуть в Болгарии)", *Gazeta*, 17 January 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²⁴⁶ *Ibid.*

²⁴⁷ *Ibid.*

²⁴⁸ Beliaikov, Evgenii': "Tranziter stavit usloviia postavchshiku (Транзитер ставит условия поставщику)", *Gazeta*, 18 January 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²⁴⁹ "Bulgaria joins South Stream gas project", *Oil and Gas Eurasia*, 21 January 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁵⁰ "Gazprom and ENI establish JV to implement South Stream project", *Oil and Gas Eurasia*, 21 January 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁵¹ Smolchenko, Anna: "South Stream signed after night out", *The Moscow Times*, 21 January 2008 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

country that was considered to be a future transit partner for the pipeline, whose territory Moscow obtained the right to use for South Stream.²⁵² This deal was complemented with Russia's penetration into the Serbian oil and gas state company, NIS.²⁵³ If that was not enough, Gazprom also secured the permission from another potential key partner in South Stream: Austria.²⁵⁴ As in the case of Hungary, Austria's good disposition was not only positive in practical terms, but also symbolic, as Vienna was the main promoter of the chief rival of South Stream, Nabucco.

Then in February, Russia tried to make forays into Hungary, intending to agree with Budapest on a route for the pipeline through its territory.²⁵⁵ Securing the potential participation of Hungary in South Stream was essential to consolidate gains made in Bulgaria, Serbia and Austria in the last two months, especially because Budapest kept playing a double game between South Stream and Nabucco. Its enthusiasm for Nabucco did not relent, as was exemplified when Hungary sent to the ambassadors of Austria, Bulgaria, Rumania and Turkey a project of agreement for laying down Nabucco.²⁵⁶ As a result of a visit by Russia's Prime Minister (and soon President), Dmitry Medvedev, Ferenc Gyurcsany, his Hungarian counterpart agreed on joining South Stream, thus taking a step forward in the direction of what had already been considered a year earlier in February 2007.²⁵⁷ The signature took place in Moscow, where Gyurcsany traveled after the Russian visit.²⁵⁸ The delicate situation of Nabucco, and the fact that the latter had gone as far as inviting Gazprom as supplier, enabled Medvedev to magnanimously proclaim that both South Stream and Nabucco were complimentary, in rhetoric similar to that proper of the equidistant Hungary itself.²⁵⁹

In the month of April, Gazprom advanced in its plans with Slovenia as a possible new partner. A delegation headed by Alexei Miller traveled to Slovenia and met with Danilo Turk and Janez Jansa, President and Prime Minister and the discussions showed Slovenia's interest in participating in South

²⁵² "Deal with Serbia gives Russia victory in pipeline war with EU", *International Herald Tribune*, 25 January 2008 (Accessed on the 26th April 2013, from Integrum, Helsinki University).

²⁵³ Smolchenko, Anna: "NIS and South Stream deals sealed", *The Moscow Times*, 28 January 2008 (Accessed on the 26th April 2013, from Integrum, Helsinki University).

²⁵⁴ "Avstriia propustila 'Iuzhnyi Potok' (Австрия пропустила Южный поток)", 28 January 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁵⁵ Grib, Natal'ia: "Vengriiu zatiagivaiut v 'Iuzhnyi Potok' (Венгрию затягивают в Южный поток)", *Kommersant*, 26 February 2008 (Accessed on the 25th February 2013, from Integrum, Helsinki University).

²⁵⁶ *Ibid.*

²⁵⁷ *Ibid.*

²⁵⁸ Lavrov, Andrei: "Nabucco vyshel bokom (Nabucco вышел боком)", *Gazeta*, 28 February 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²⁵⁹ Kulikov, Sergei: "Vengriia primirila konkurentov (Венгрия примирила конкурентов)", *Nezavisimaia Gazeta*, 27 February 2008 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

Stream.²⁶⁰ Slovenia could become a very important partner because it opened a new route directly to Northern Italy, Gazprom's main partner. This was also positive since it both added pressure on Austria or, if Austria decided to prioritize Nabucco, it made its participation unnecessary outright.²⁶¹ At the same time, Greece officially agreed to join the project.²⁶² By early June, Gazprom was announcing that an agreement would soon be signed with Austria.²⁶³ By October, it seemed that the mercurial Hungary would also agree with Gazprom on the establishment of a JV to manage Hungary's part of South Stream through its country.²⁶⁴

It is true that South Stream had a certain disadvantage compared to Nabucco, at least if we are to believe what Jeremy Ellis, from the German RWE (having become in 2008 the sixth partner for Nabucco) stated: according to him, South Stream was to cost around US\$10bill whereas Nabucco, from Turkey to Austria, only US\$7bill.²⁶⁵ However, in this calculation, the Trans-Caspian pipeline, to be eventually built if Turkmen gas was wanted, was not included. That would necessarily increase costs and nuance this comparison. Unless Nabucco managed to break the deadlock regarding Iran's natural gas, the first stage of Nabucco could only export gas from Azerbaijan, and even this was doubtful (see section below). In May 2008, the consortium assessed the costs and stated they would jump from €4,6bill, as initially planned, to €7,9bill.²⁶⁶

In October 2008, Gazprom approved in its report on the development of the gas sector to 2030, that South Stream would be ready at the earliest, two years later than what Alexei Miller had promised in January of the same year; instead of 2013, South Stream would not be operative earlier than 2015.²⁶⁷ The initial projected capacity of the pipeline would be 31bcm per year, exactly the same amount of natural gas that Nabucco was supposed to be able to transport.

²⁶⁰ "Gazprom and Slovenia discussed possible participation in South Stream project", *Oil and Gas Eurasia*, 14 April 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁶¹ Grib, Natal'ia: "Avstriia vypadaet iz "Iuzhnogo Potoka" (Австрия выпадает из "Южного потока")", *Kommersant*, 14 April 2008 (Accessed on the 25th February 2013, from Integrum, Helsinki University).

²⁶² "Greece to join Russian-backed South Stream gas pipeline project", *International Herald Tribune*, 15 April 2008 (Accessed on the 26th April 2013, from Integrum, Helsinki University).

²⁶³ Grivach, Alexei': "Poslednii' oplot Nabucco padaet (Последний оплот Nabucco падает)", *Vremia Novostei'*, 9 June 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²⁶⁴ Savinykh, Anastasia: "Iuzhnyi' potok" do Vengrii dovedet (Южный поток до Венгрии доведет)", *Izvestiia*, 1 October 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²⁶⁵ "Nabucco deshevle "Iuzhnogo Potoka"? (Nabucco дешевле Южного потока)", *RusEnergy*, 20 March 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

²⁶⁶ "Nabucco podorozhal na 3 milliarda evro (Nabucco подорожал на 3 миллиарда евро)", *RusEnergy*, 29 May 2008 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

²⁶⁷ Malkova, Irina; Mazneva, Elena and Zotova, Elena: "Medlennyi' potok (Медленный поток)", *Vedomosti*, 3 October 2008 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

At this stage, with South Stream having acquired substantial chances to come about, a delicate question surfaced regarding the possibilities of using the Black Sea as a route for the new pipeline: would the Gazprom/ENI consortium use Ukraine's or Turkey's territorial waters? Russia was likely to fall prey to similar obstacles as in the case of Nord Stream, where Estonia, Finland and Sweden's jurisdiction on their respective territorial waters left Nord Stream at the moment in a state of vagueness. As we had the chance to see in chapter 7, February and March 2008 were months of extreme tension with Ukraine; the news of Hungary's signature to join South Stream in Moscow (the signature took place on the 28th of February, five days before Gazprom cut 25% of gas to Ukraine) were quite unwelcome for Kiev, which (quite accurately) suspected South Stream as a device to "switch off" Ukraine and reduce its power as transit country. However, the fact is that South Stream was planned to go through the Ukrainian shelf.²⁶⁸ Timoshenko's new government (see chapter 7) in fact insisted on the construction of the alternative White Stream, which would link the Caucasus with Europe through Ukraine.²⁶⁹ The discourse in Ukraine was that permission would be granted for South Stream, if White Stream was agreed in Europe.²⁷⁰ Apart from Ukraine, if South Stream was to reach Bulgaria, Rumania was also a necessary route, and Rumania was a partner in Nabucco.²⁷¹ If Ukraine persisted in its negative, and with Timoshenko on board South Stream's permission to use Ukraine's shelf was almost impossible, Turkey remained a difficult option: if Turkey initially was to host the extension of Blue Stream to supply Europe with more Russian gas, it had been excluded in favor of Bulgaria.²⁷²

The main question that was worth considering once Gazprom had decided to ditch Blue Stream II and propose a more ambitious project instead, was which would be the source for the new gas. Part of the first shipments was to come from gas fields previously operated by the former YUKOS,²⁷³ where Eni had acquired assets.²⁷⁴ The main suspicion though, was that Gazprom simply wanted to secure Nabucco's potential resources from Central Asia,²⁷⁵ or as might happen with Nord Stream, simply redirect gas

²⁶⁸ Grib, Natal'ia and Gavrish, Oleg: "V "Iuzhnom Potoke" vsplyla Ukraina (В Южном потоке всплыла Украина)", *Kommersant*, 29 February 2008 (Accessed on the 25th February 2013, from Integrum, Helsinki University).

²⁶⁹ *Ibid.*

²⁷⁰ *Ibid.*

²⁷¹ "Budapest Business Journal: Ukraina i Rumyniia mogut zablokirovat' "Iuzhnyi' Potok" (Budapest Business Journal: Украина и Румыния могут заблокировать Южный поток)", *RusEnergy*, 3 March 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

²⁷² "Ukraina mozhет pritomozit' razognavshii'sia "Iuzhnyi' Potok" (Украина может притормозить разогнавшийся Южный поток)", *Neftegaz.ru*, 29 February 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁷³ "Gazprom, Eni plan big gas pipeline bypassing Turkey", *Oil and Gas Eurasia*, 25 June 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁷⁴ *Ibid.*

²⁷⁵ Grib, Natal'ia: "Poiavilsia monstr! chto eshche o nas mog podumat' obyvatel' (Появился монстр! Что еще о нас мог подумать обыватель)", *Kommersant*, 29 June 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

transported through Ukraine and deprive Ukraine of its strategic relevance. Gazprom publicly assumed a "fair play" position in relation to Nabucco, as the company even announced during June 2007 that it was ready to enter Nabucco itself if the consortium accepted.²⁷⁶ Gazprom's mantra was that they would not call into question Nabucco's viability as long as it could secure its own resources and thus guarantee its profitability;²⁷⁷ it might be reasonable to assume that the other side of this discourse was that the same applied to South Stream. If so, Gazprom needed to convince that there was a (new) resource basis for the project.

In this respect, it may be argued that the reasonable doubts as to whether South Stream would be able to provide new resources put it at a disadvantage in comparison to Nabucco. However, as will be seen in the section below, once Nabucco started facing serious problems with Turkmenistan, Azerbaijan and of course, Iran, the promising initial supplier, who soon dropped out from the race for obvious political reasons, already existing Russian supplies through a new route were at an advantage versus no supplies at all. This became especially true once Nabucco's deadline was pushed from 2011 to 2013, the same year South Stream was supposed to start working.²⁷⁸ Once Nabucco lost the temporal advantage, it would be left with less time to "prove" it could provide at least some supplies while South Stream was not yet active.

Nabucco

The project of Nabucco entered an important phase during 2005, when relations between Russia and Ukraine were steadily worsening (see chapter 6). On 29th June 2005 an agreement was signed, in which the company "Nabucco Gas Pipeline International" was established, which substituted its predecessor, solely devoted so far to technical aspects. The newly established company was to develop the project.²⁷⁹

Nabucco entered this period with the very ambitious projection of opening a natural gas export route to Europe from a large array of potential suppliers: Iran, Azerbaijan, Turkmenistan, Kazakhstan and even Irak, Syria to which could later come Egypt and Libya.²⁸⁰ The first stage of the project was focused on Iran, which as early as January 2004, had signed a memorandum to take part in the project.²⁸¹

²⁷⁶ *Ibid.*

²⁷⁷ *Ibid.*

²⁷⁸ "Nabucco i "Iuzhnyi' Potok" pridut k finishu vmeste (Nabucco i Южный поток придут к финишу вместе)", *Neftegaz.ru*, 20 March 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁷⁹ "Ugroza Navukhodonosora (Угроза Навуходоносора)", *Neft Rossii*, 15 October 2005 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁸⁰ *Ibid.*

²⁸¹ Saprykin, Vladimir: "Za kulisami iadernoi' programmy Irana (За кулисами ядерной программы Ирана)", *Zerkalo Nedeli*, 17 August 2005 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

Nabucco's reliance on Iran implied the problem of the uncertainty regarding Iran's natural gas reserves. However, this was not by far the real obstacle. The US, while promoting since the decade of the 90s energy diversification away from Russia in the whole Eurasian space, in what was called the "New Great Game", remained adamantly opposed to any kind of cooperation involving Teheran. As the Energy Commissar of the European Commission, Andris Piebalgs had to concede already in February 2006, the problem of Iran's program of enrichment of uranium had to be solved first.²⁸²

In this complex web of supply, there was another country with the potential to play a significant role in Nabucco: Azerbaijan. Its advantage lay in the fact of its proximity, so it could become crucial in a first stage of the project, before more sizable resources had been secured from other countries. Thanks to its significant reserves in the offshore field of Shah Deniz, Azerbaijan was already supplying the BTE pipeline inaugurated in 2006, with Turkey receiving the first volumes of natural gas in 2007. The challenge for Nabucco was whether Shah Deniz could be further developed early enough as to secure the project's initial viability. In the BTE project, it was foreseen that Shah Deniz serves the regional supply, with Georgia and Turkey being the only consumers. If the still relatively reduced volumes of gas that Turkey was consuming from Azerbaijan left sizable volumes of natural gas for Nabucco, the paradox was that scarce consumption in Turkey imperiled Shah Deniz's profitability and thus its eventual expansion.²⁸³ In the following years, Azerbaijan would prove a complicated partner, while relying on the fickle Turkmenistan and its ever-changing multivectorial energy policy would prove even worse.

Nabucco after the January 2006 Dispute

The (short, if compared to 2009) effects of the January 2006 energy dispute were necessarily registered by all those who found post-Soviet export routes risky. The lesson to be drawn was poised to be the exact opposite between those deeming transit countries like Ukraine as irresponsible, and those, who on the contrary, blamed Gazprom as the ultimate supplier. This latest narrative played into the interests of Nabucco's promoters, and with this narrative holding the upper hand in the aftermaths of the dispute, the situation seemed more favorable than ever for the Austrian ÖMV as the main promoter of the ambitious project. The Hungarian Minister of Economy, Janos Koka's, support for Nabucco (Hungarian MOL was

²⁸² "ES vernetsia k proektu Nabucco (EC вернется к проекту Nabucco)", *Kommersant*, 21 February 2006 (Accessed on the 21st April 2013, from Integrum, Helsinki University).

²⁸³ Saprykin, Vladimir: "Iz zhizni gazoprovodov: iuzhnii' Kavkaz idet ot Rossii k Iranu (из жизни газопроводов_ЮЖНЫЙ КАВКАЗ ИДЕТ ОТ РОССИИ К ИРАНУ)", *Zerkalo Nedeli*, 12 January 2005 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

already involved),²⁸⁴ was certainly worrisome for Russia. The interest expressed by E.ON-Ruhrgas and GDF, usual partners of Gazprom, was even more important for Nabucco, given the importance of Germany and France, which could become significant consumers of Iranian gas.²⁸⁵ With the European Commission, which through its Energy Commissar, Andris Piebalgs, had already expressed its support for the construction of the pipeline in December 2005,²⁸⁶ these movements by national governments had to be seriously considered by the Russian government.

An agreement was signed in June 2006 in Vienna between all members of the consortium to start the project.²⁸⁷ Though initially planned to be fully operative by 2011,²⁸⁸ the project was now to be ready for 2010.²⁸⁹ Beyond its merely declarative effect, the support of the EU translated into financial support from the part of the EBRD, which was ready to finance up to 20%-30% of the construction.²⁹⁰ When the European Commission presented its new energy policy in January 2007, this contained the pipeline Nabucco as one of the four connectors that were to improve the EU's internal energy interconnectedness as well as the access to sources without the EU space.²⁹¹

However, probably in line with the uncertainties that were piling up regarding both source and transit issues, and which are briefly reviewed below, a EU Summit devoted to Nabucco in March 2007 decided to postpone the final decision on the whole project for 2008.²⁹² The probable dependence of

²⁸⁴ "Gazpromu ponravilos' (Газпрому понравилось)", *Neftegaz.Ru*, 10 January 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University). Moldavia's similar statements, in spite of not being part of Nabucco (and never eventually becoming part thereof), were in tune with the renewed interest for Nabucco (see: "Dobavit' otzyv (добавить отзыв)", *Vedomosti*, 16 January 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁸⁵ "Iranskii' gas stanet konkurentom rossii'skomu (Иранский газ станет конкурентом российскому)", *Neftegaz.Ru*, 16 January 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University); "GDF podderzhivaet proekt Nabucco (GdF поддерживает проект Nabucco)", *RusEnergy*, 27 February 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University). A note of soberness must be included here, following the assessment by *Vedomosti* at the time, which pointed to the fact that as opposed to the 170-180bcm supplied by Gazprom to Europe, Nabucco's capacity was expected to reach at the most, only 30bcm; Nabucco's threat was therefore relative (see: "Ot redaktsii: Energoopasno (От редакции: Энергоопасно)", *Vedomosti*, 16 January 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁸⁶ Miklashevskiaia, Alena and Butrin, Dmitri: "ES nai'det vinovnikov provala energoreformy (ЕС найдет виновников провала энергореформы)", *Kommersant*, 20 February 2006 (Accessed on the 21st April 2013, from Integrum, Helsinki University).

²⁸⁷ "U SEGa i "Golubogo Potoka" poiavilsia ser'eznyi' konkurent (У СЕГа и Голубого потока Газпрома появился серьезный конкурент)", *Neftegaz.Ru*, 27 June 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁸⁸ "Gaz iz Azerbaidzhana i Irana poi'det v Evropu cherez Turtsiiu (Газ из Азербайджана и Ирана пойдет в Европу через Турцию)", *RusEnergy*, 28 June 2006 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

²⁸⁹ Butrin, Dmitrii: "ES uskorit stroitel'stvo gazoprovoda Nabucco (ЕС ускорит строительство газопровода Nabucco)", *Kommersant*, 29 June 2006 (Accessed on the 21st January 2013, from Integrum, Helsinki University).

²⁹⁰ "Evropa ishchet al'ternativu "Gazpromu" (Европа ищет альтернативу "Газпрому")", *Vedomosti*, 30 June 2006 (Accessed on the 8th February 2013, from Integrum, Helsinki University).

²⁹¹ Medetskii', Anatolii': "Europeans seek one voice on energy", *The Moscow Times*, 11 January 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

²⁹² Grib, Natalia and Konstantinov, Aleksandr: "Kazakhskii' drug dorozhe zapadnykh dvukh (Казахский друг дороже западных двух)", *Kommersant*, 10 May 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

Nabucco on Azerbaijan as initial, if not only supplier (and even this would prove unsure) after the Iranian option faded and Turkmenistan seemed to be buoyed both by Russia and most importantly, by China (see below),²⁹³ cast shadow on this optimism: in October 2007, Azerbaijan announced that production of Shah Deniz II, on which Nabucco would have to rely, might be postponed to 2013 from 2012 as initially planned.²⁹⁴

In October 2007, Nabucco received additional support when the German energy company RWE announced its desire to join the consortium.²⁹⁵ This came along with the explicit support of the German Minister of Economy, Michael Gloss to Azerbaijan's gas.²⁹⁶

Sources for Nabucco

Interest in Europe for Nabucco underlined the inherent challenges mentioned in the section above. If Iran's gas could not become a real alternative, then future consumers had to turn to Central Asia and the Caucasus, with Turkmenistan as a substitute for Iran, and with Azerbaijan providing gas for the first stage. Turkmen gas represented a particular obstacle, as the construction of a Trans-Caspian pipeline represented a clear challenge in terms of costs. In fact, it was reported in March 2006, that the costs foreseen jumped twice as compared to initial estimations from 1997,²⁹⁷ when such pipeline was first considered.

The agreement signed in Vienna in June 2006 introduced important changes as for the sources of gas. Pending progress in Central Asia and given the uncertainty as for Iranian gas, Nabucco needed to ensure that Azerbaijan's gas would be available for the first stage. It was thus agreed that Shah Deniz's natural gas would have to be developed for Europe.²⁹⁸ Thus, before reaching its total capacity of 31bcm per year, Azerbaijan would ensure a supply of 10bcm in its initial stage.²⁹⁹

²⁹³ "Iz trekh proektov eksporta gaza naimen'shie shansy na realizatsiiu imeet Transkaspitskii?" (Из трех проектов экспорта газа наименьшие шансы на реализацию имеет Транскаспийский?), *RusEnergy*, 4 October 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

²⁹⁴ "Azerbai'dzhan otlozhit na god nachalo vtoroi' fazy na "Shakhdeniz" (Азербайджан отложил на год начало второй фазы на "Шахдениз")", *RusEnergy*, 2 October 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

²⁹⁵ Trempel', Aleksandr: "RWE voi'det v Nabucco (RWE ВОЙДЕТ В NABUCCO)", *Gazeta*, 18 October 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

²⁹⁶ "Germaniia zainteresovana v postavkakh azerbai'dzhanskogo gaza (Германия заинтересована в поставках азербайджанского газа)", *RusEnergy*, 19 October 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

²⁹⁷ "Stoimost' transkaspitskogo gazoprovoda mozhet uvelichit'sia rovno v 2 raza (Стоимость транскаспийского газопровода может увеличиться ровно в 2 раза)", *RusEnergy*, 29 March 2006 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

²⁹⁸ Butrin, "ES uskorit", *op. cit.*

²⁹⁹ *Ibid.*

With the goal of securing Azerbaijan's contribution to Nabucco, the Austrian ÖMV traveled in January 2007 to Baku.³⁰⁰ The reasons for such a trip were evident: the consortium planned to start the construction of the pipeline from Turkey to Austria in 2007 already, while natural gas was still absent.³⁰¹ Baku stated at the time they would be able to launch exports from Shah Deniz by 2012, which would force Nabucco to a delay of one year.³⁰² However, with 16bcm being the foreseen volume of production, from which 6bcm were to be supplied to Turkey, 800bcm to Georgia and 9bcm reserved for internal consumption, the question was whether any gas at all would be available for the consortium.³⁰³ The pressure on Azerbaijan to supply enough gas for Nabucco and to secure its profitability was great, with the US government, which had already strongly lobbied for the construction of the BTC and BTE pipelines, trying to influence this time too.³⁰⁴ In fact, a memorandum of cooperation between Washington and Baku was signed in late March.³⁰⁵

Given this situation, ÖMV's delegation preferred to concentrate on securing Azerbaijan's support for transit of an eventual Trans-Caspian pipeline for Turkmen and Kazakh gas.³⁰⁶ Independent of the success that Azerbaijan's cooperation might have in the future to secure transit, the fact is that without a starting contribution by Shah Deniz's gas, the consortium could hardly take off. In line with the consortium's desires of securing its territory for transit, Azerbaijan, possibly in reaction to Gazprom's price increases from the 1st of January 2007 (Baku paid now US\$230bcm, as much as in Europe), lobbied for the inclusion of Turkmenistan in the project.³⁰⁷ Apart from the objective interest Baku had, this could also be meant in the understanding that first supplies should come immediately from Central Asia, given the limited resources from Shah Deniz. And in this respect, Baku made things clear: if supplies were not guaranteed, Azerbaijan expressed it was not worth joining Nabucco, making clear that Azeri resources did not suffice.³⁰⁸ The Hungarian MOL visit in May to Azerbaijan, confirmed that both Hungary and

³⁰⁰ "V Azerbaidzhanе proshla vstrecha s predstavitelamy OMV (В Азербайджане прошла встреча с представителями OMV)", *RusEnergy*, 25 January 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³⁰¹ Grivach, Alexei': "Iuzhno-Evropei'skii' front (Южно-Европейский фронт)", *Vremia Novostei'*, 26 January 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

³⁰² *Ibid.*

³⁰³ *Ibid.*

³⁰⁴ "SshA sosdaiut v Evrope al'ternativu rossii'skim truboprovodam (США создают в Европе альтернативу российским трубопроводам)", *RusEnergy*, 16 March 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³⁰⁵ "Azerbaidzhan i SShA podpisali memorandum ob energeticheskoi' bezopasnosti (Азербайджан и США подписали меморандум об энергетической безопасности)", *RusEnergy*, 23 March 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³⁰⁶ Grivach, "Iuzhno-Evropei'skii' front", *op. cit.*

³⁰⁷ Grivach, Alexei' and Dubnov, Arkadii': "Bor'ba za nasledie Turkmenbashi (Борьба за наследие Туркменбаши)", *Vremia Novostei'*, 22 March 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

³⁰⁸ "Azerbaidzhan mozhет otkazat'sia ot uchastiia v Nabucco (Азербайджан может отказаться от участия в Nabucco)", *RusEnergy*, 29 March 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

Azerbaijan were interested in principle in continuing work on Nabucco;³⁰⁹ Azerbaijan also showed its enthusiasm for Nabucco before American officials, active in promoting energy diversification away from Russia.³¹⁰ However, this did not change the essence of the problem, which was that Azerbaijan still regarded its role more as transit country than as supplier.

The US, which, as already mentioned, conducted an active lobbying policy to promote Nabucco,³¹¹ presented a very optimistic vision of the potential of Azerbaijan as a supplier of natural gas. According to Mathew Bryza, Deputy Assistant Secretary of State for Energy Affairs, Azerbaijan could supply by 2016 as much as a total of 50bcm per year, providing 25-31bcm for Nabucco and still having the capacity to provide 8-11bcm to another planned project, the Turkey-Greece-Italy (TGI) Interconnector.³¹² If trusting this assessment, Azerbaijan could in fact cover almost all of Nabucco's projected capacity. Since the fiasco of the agreement on the Caspian pipeline between Turkmenistan, Kazakhstan and Russia, Azerbaijan itself started insisting it had enough resources for Nabucco.³¹³ However, prospects did not appear so optimistic to all actors involved: The TGI Interconnector, "Poseidon", represented a threat unless Azerbaijan could increase its production as the US promised.³¹⁴ The proposal to the Azeri SOCAR to enter the Nabucco consortium, responded to the sense of increased competition for scarce resources.³¹⁵ Thus, the US strengthened its efforts for the construction of Trans-Caspian pipelines to provide enough natural gas to Nabucco, and in avoidance with the Iranian territory (which, as seen below, was at some point favored by Turkey);³¹⁶ The US would provide technical and economic assistance to Azerbaijan to consider the construction of two pipelines, one from Kazakhstan and another from Turkmenistan.

³⁰⁹ "Azerbai'dzhan gotov vystupat' transitnoi' stranoi' dlia transportirovki gaza v Evropu (Азербайджан готов выступать транзитной страной для транспортировки газа в Европу)", *RusEnergy*, 21 May 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³¹⁰ "Azerbai'dzhan vystupaet za skorei'shuiu realizatsiiu proekta NABUCCO (Азербайджан выступает за скорейшую реализацию проекта NABUCCO)", *RusEnergy*, 31 May 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³¹¹ The US was even trying to entice Irak to become a supplier for Nabucco (see: Gavshina, Oksana: "Amerika ishchet al'ternativu Gazpromu (Америка ищет альтернативу Газпрому)", *Gazeta*, 7 June 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

³¹² "Azerbaijan could produce 50 Bcm/year of gas by 2016", *Oil and Gas Eurasia*, 7 June 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³¹³ "Kaspii'skoe Solo (КАСПИЙСКОЕ СОЛО)", *Neftegazavaia Vertikal'*, 31 August 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³¹⁴ Grivach, Alexei': "Nabucco protiv "Poseidona" (Nabucco против "Посейдона)", *Vremia Novostei'*, 8 June 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

³¹⁵ *Ibid.*

³¹⁶ "SSha usilivaiut podderzhku gazoprovodu NABUCCO (США усиливают поддержку газопроводу NABUCCO)", *RusEnergy*, 20 August 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

More marginally, there were also discussions with Kazakhstan, another potential supplier, with whom Nabucco's partner, however, faced the same obstacle as with the Trans-Caspian pipeline from Turkmenistan. Here, the initiative was assumed not only by partners of Nabucco, but by Azerbaijan itself, as when Azerbaijan's Minister of Foreign Affairs Elmar Mammadyarov visited Astana in late February to discuss possible supplies from Kazakhstan.³¹⁷ Worse than in the case of Turkmenistan, as we will see below, was the reality of Kazakhstan's closeness to Russia, which further reduced the margin of action. Kazakhstan was interested enough to draft a proposal to the European Commission for financing a Trans-Caspian pipeline. However, in conversations with US officials, the Kazakh side clearly stated consultations with Russia were necessary and even tentatively proposed to connect Russia to the future pipeline.³¹⁸ The impossibility of adding Kazakhstan to the project was unfortunate, as natural gas production was expected to increase to as much as 40 to 50bcm in 2014.³¹⁹ A team from the European Union, including the German Minister of Foreign Affairs himself, Frank-Walter Steinmeier, travelled to Central Asia in March to lobby gas producers, including Kazakhstan,³²⁰ to find that Astana did not support the Trans-Caspian pipeline.³²¹

In any case, by September 2007, European efforts necessarily concentrated on the only viable alternative, either for eventual transit from Central Asia, or in order to secure resources from the country itself: Azerbaijan. Thus, in a visit to Baku, The Austrian Minister of Economics Martin Bartensteiner, proposed the Azeri SOCAR to become a partner in Nabucco, with the Azeri counterpart ensuring that Azerbaijan would produce, in the worst case, as much as 21bcm from the second stage of Shah Deniz by 2011, thus ensuring a sizable supply for the pipeline to Europe.³²² Soon, the President of SOCAR, Rovnag Abdullaev, stated that new estimates pointed to twice as much natural gas in Shah Deniz as initially thought.³²³ If this increase in reserves was confirmed, then Nabucco could receive enough resources from Azerbaijan, at least for initial supplies, even if some of the country's natural gas eventually went to the rival "Poseidon",³²⁴ as the second stage of Shah Deniz would add 16bcm instead of

³¹⁷ Socor, Vladimir: "Discussions intensify with Kazakhstan on Trans-Caspian gas pipeline", *Oil and Gas Eurasia*, 5 March 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³¹⁸ *Ibid.*

³¹⁹ *Ibid.*

³²⁰ Dempsey, Judy: "Letter from Germany: For Europe, evershifting lines in the drive for oil", *International Herald Tribune*, 21 March 2007 (Accessed on 26th April 2013, from Integrum, Helsinki University).

³²¹ Kashin, Vasilii': "Truby ne nado (Трубы не надо)", *Vedomosti*, 9 March 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³²² "GNKAR priglashena stat' aktsionerom gazoprovoda NABUCCO (ГНКАР приглашена стать акционером газопровода NABUCCO)", *RusEnergy*, 21 September 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³²³ Grivach, Alexei': "Udvoenie Shakh-Deniza (Удвоение Шах-Дениза)", *Vremia Novostei'*, 28 September 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

³²⁴ *Ibid.*

8bcm per year as planned before.³²⁵ Thus, according to Natick Aliev, Minister of Industry and Energy of Azerbaijan, Azerbaijan could provide 12bcm per year to Nabucco, to which the consortium should find 16bcm if it wanted to use the pipeline in maximum capacity.³²⁶

Assuming that Azerbaijan could finally provide these volumes to Nabucco, the prospects for filling up the rest of the pipeline remained nevertheless quite obscure. The Iranian route, arguably the most promising, would remain closed, despite the surprising proposal by Matthew Bryce, that Iran could eventually provide as much as 5-12bcm per year to Nabucco.³²⁷ Javier Solana's (High Commissar for Foreign Affairs of the EU) efforts to buoy Turkmenistan to make some gas available for Nabucco through a Trans-Caspian pipeline appeared equally futile,³²⁸ in spite of the fact that Ashgabad was pressuring Gazprom to accept higher prices (see chapter 7) and the September deadline for confirming the construction of the new Caspian pipeline through Russia had been missed. Azerbaijan approved its participation in Nabucco, but equally positive messages from Kazakhstan were more rhetoric than anything else.³²⁹

Whatever optimism could be found in the active engagement of both the EU and the US, some could clearly see through misplaced voluntarism, as was the case with the President of the Energy Charter Treaty, André Mernier, who called Nabucco a "still-born" project.³³⁰ Mernier made such statements given the evidence that Nabucco did not really have enough secure resources.³³¹ The European Union's assessment of the Trans-Caspian's economic rationality after a meeting in Brussels with Azerbaijan, Kazakhstan, Georgia and Turkmenistan,³³² given the reality of the uncompetitive position of the EU in its race against Russia and China for Central Asia's gas resources, was probably an effort to improve as

³²⁵ *Ibid.*

³²⁶ "Azerbaij'dzhan vdokhnul v "Nabucco" novyi' gaz (Азербайджан вдохнул в Набукко новый газ)", *Neftegaz.ru*, 1 October 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³²⁷ Savchenko, Gennadii' and Liubartas, Vidas: "Skovannye odnoi' energotsep'iu (Скованные одной энергоцепью)", *Gazeta*, 11 October 2007 (Accessed on the 7th April 2013, from Integrum, Helsinki University).

³²⁸ Panfilova, Viktoriia: "Solana priekhal za iasnost'iu i gazom (СОЛАНА ПРИЕХАЛ ЗА ЯСНОСТЬЮ И ГАЗОМ)", *Nezavisimaia Gazeta*, 11 October 2007 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

³²⁹ Mamedov, Sokhbet: "Baku i Astana podderzhali projekt Nabucco (БАКУ И АСТАНА ПОДДЕРЖАЛИ ПРОЕКТ NABUCCO) ", *Nezavisimaia Gazeta*, 26 October 2007 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

³³⁰ Grivach, Andrei': "Mertvorozhdennyi' gazoprovod (Мертворожденный газопровод)", *Vremia Novostei'*, 30 October 2007 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

³³¹ *Ibid.*

³³² Mamedov, Sokhbet: "Evrosioz odobril stroitel'stvo gazoprovoda v obkhod Rossii (Евросоюз одобрил строительство газопровода в обход России)", *Nezavisimaia Gazeta*, 3 December 2007 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

much as possible the prospects of Nabucco precisely in a moment when it remained in the losing side. Even the US acknowledged that Nabucco was facing obstacles.³³³

The delicate situation of Nabucco was exemplified by the contradictory offer made to Gazprom in February 2008, of supplying gas to the project.³³⁴ Even more devastating was the sound of news that the consortium would push the deadline for entering in service two years later than foreseen, in 2013 instead of 2011.³³⁵ However, neither was this new deadline a real guarantee for having enough gas, at least for its initial supply, as Azerbaijan's resources seemed, according to analysts, insufficient, to cover 10bcm which should be the initial supply: According to *Nezavisimaia Gazeta*, in 2013, Azerbaijan might be producing around 18-19bcm per year; with an internal consumption of around 12bcm and 6.6bcm promised to Turkey and 0.3-0.8bcm to Georgia, any gas for Nabucco should necessarily come from volumes supplied to Turkey.³³⁶ Mathew Bryza's statement that Azerbaijan had not only enough gas for Nabucco, but also for the TGI,³³⁷ was simply a vain effort of voluntarism. A new assessment provided in late November 2008 went in the same direction and was thus quite pessimistic in this respect: Azerbaijan could supply natural gas to Nabucco only in the event of the second stage of Shah Deniz being developed;³³⁸ This second stage, not yet approved at that moment, would supply in the most optimistic case by 2015, 8,6bcm more per year, from which only 7bcm could potentially go to Nabucco.³³⁹

Turkmenistan's promise to an EU delegation in April 2008, to supply natural gas to Nabucco could not be considered as any more realistic.³⁴⁰ Turkmenistan promised that as much as 10bcm could be supplied to Nabucco by 2009.³⁴¹ True, this announcement by Turkmenistan had the effect of increasing

³³³ "Amerikantsy prisnali, chto razrabatyvaemye imi proekty truboprovodov sil'no ustupaiut rossiiskim sistemam (Американцы признали, что разрабатываемые ими проекты трубопроводов сильно уступают российским системам)", *RusEnergy*, 6 December 2007 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

³³⁴ Dempsey, Judy: "EU-sponsored pipeline to open up to Russian gas", *International Herald Tribune*, 6 February 2008 (Accessed on the 26th April 2013, from Integrum, Helsinki University).

³³⁵ "Nabucco nakinuli sroka (Nabucco накинuli срока)", *Neftegaz.ru*, 6 February 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³³⁶ Mishin, Vladimir: "Za spinoi' politiki - ushi kommertsii (За спиной политики – уши коммерции)", 11 March 2008 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

³³⁷ "Azerbai'dzhanskogo gaza khvatit na zapolneniie TGI i Nabucco (Азербайджанского газа хватит на заполнение TGI и Nabucco)", *RusEnergy*, 27 March 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³³⁸ Mishin, Vladimir and Gavshina, Oksana: "Gazovoe svatovstvo (Газовое сватовство)", *Gazeta*, 28 November 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

³³⁹ *Ibid.*

³⁴⁰ "ES napolnit Nabucco turkmenskimi gazom (ЕС наполнит Nabucco туркменским газом)", *RusEnergy*, 11 April 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³⁴¹ Kashin, Vasilii: "Gazovoe obeshchanie (Газовое обещание)", *Vedomosti*, 15 April 2008 (Accessed on the 8th April 2013, from Integrum, Helsinki University).

optimism in Azerbaijan with regard to the prospects of the pipeline.³⁴² Another good item of news for Nabucco was the apparent activation of an unexpected front, that of Irak, another potential supplier for Nabucco, which was much more accessible, in geographical terms, than Turkmenistan, and which promised a supply of 5bcm per year in its first stage.³⁴³ In May the EU had also secured the agreement from Egypt as potential supplier of 2bcm.³⁴⁴ It is with the benefit of hindsight that we may consider it unfortunate that news confirming the immense reserves that Turkmenistan possessed did not arrive much earlier. By October 2008, it was known that previous assessments from Turkmenistan, pointing to as much as 14Tcm, were realistic.³⁴⁵

It is with the benefit of hindsight that we may clearly consider all this good news for Nabucco as unrealistic. How did Russia perceive it? Gazprom had actively moved in Central Asia and was probably not very worried over any intention from the side of Turkmenistan to open the Trans-Caspian line. Even if Russia failed (as it eventually did), China was a much better candidate to gain the upper hand than the EU (this is what happened and it was probably clear at the time that the EU was in a losing position). The Iranian option was the most promising for Nabucco. However, poor political relations between Teheran and the US blocked any realistic participation of Iran in Nabucco; they also precluded Turkmenistan's chances for sending gas through a much easier route than that of the Caspian. As for Irak, the turmoil in which the country was engulfed represented the best guarantee for its non participation.³⁴⁶ The only realistic partner was Azerbaijan, even if as we have seen, it hardly represented a big promise for the EU. In any case, the offer that Gazprom made to Baku, namely, to purchase its gas at "market prices",³⁴⁷ was

³⁴² Mamedov, Sokhbet: "Azerbai'dzhan gotov kachat' Turkmenskii' gaz v Evropu (АЗЕРБАЙДЖАН ГОТОВ КАЧАТЬ ТУРКМЕНСКИЙ ГАЗ В ЕВРОПУ)", *Nezavisimaia Gazeta*, 16 April 2008 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

³⁴³ "ES i Irak gotoviat soglasenie po energii (ЕС и Ирак готовят соглашение по энергии)", *Neftegaz.ru*, 17 April 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³⁴⁴ "Evrosoiuz dogovorilsia s Egiptom i Irakom o dopolnitel'nykh postavkakh gaza (Евросоюз договорился с Египтом и Ираком о дополнительных поставках газа)", *RusEnergy*, 6 May 2008 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

³⁴⁵ Gaffney Cline & Associates calculated that the South Yolotan-Osman field had between 4Tcm and 14Tcm; so far, the BP's estimation was of 2.67Tcm for the whole country's reserves (Chazan, Guy: "Turkmenistan gas field is one of world's largest", *World Street Journal*, 16 October 2008, at <http://www.wsj.com/articles/SB122409510811337137> (Accessed on the 2nd March 2015)).

³⁴⁶ The Iraqi option would periodically resurface in the next years, as in 2010 ("Georgia and Iraq to supply Nabucco Pipeline", *Pipelines International*, September 2010, at http://pipelinesinternational.com/news/georgia_and_iraq_to_supply_nabucco_pipeline/043726/ (Accessed on the 2nd March 2015) and even into 2012, where in a clear example of self-delusion or propaganda, Nabucco's spokesman talked of gas from Northern Iraq as a viable option ("Nabucco could still use Iraqi gas", *Iraq-Business News*, 25 February 2012, at <http://www.iraq-businessnews.com/2012/02/25/nabucco-could-still-use-iraqi-gas/> (Accessed on the 2nd March 2015)).

³⁴⁷ Grivach, Alexei': "Dorogo i nadolgo (Дорого и надолго)", *Vremia Novostei*, 3 June 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

clearly directed at precluding Nabucco of any chance of success. Hungary's Prime Minister travelled to Azerbaijan in July to try to keep the Azeri option alive as the only realistic option.³⁴⁸

As if all the problems Nabucco was facing with its potential supply sources were not enough, the war in Georgia, when Russia intervened in support of the break-away entities of Abkhazia and North-Ossetia, cast a shadow over the eventual security of a pipeline running across such an unstable region.³⁴⁹ In fact, what appeared as a severe blow to Nabucco, when Azerbaijan declared it would not take part in Nabucco, in spite of the US insistence (this happened in the context the US Vice-President's, Dick Cheney, visit to Azerbaijan), could have been related to the assertive move by Russia against Georgia some weeks earlier and to Baku's desire to maintain good relations with its powerful neighbor.³⁵⁰ This information was soon rejected as wrong from Azerbaijan.³⁵¹ Amid the great uncertainty that shrouded the destiny of Nabucco, the project though, received good news from Turkmenistan concerning its potential resources and its prospect then, of supplying Nabucco: according to an international audit by the British company "Gaffney, Cline & Associates," Turkmenistan's resources were as big as the government had been claiming and left enough resources for Russia, China and Nabucco.³⁵²

Transit for Nabucco and the role of Turkey

Nabucco did not face smooth relations with key transit countries either. Apart from complicated relations with Azerbaijan, simultaneously the potential producer and needed transit country for Central Asian resources (as Iran was excluded either as producer or transit country), Turkey was necessarily the bridge to Europe for all supplies. Unfortunately, Turkey was no easy partner either.

After the possible participation of the French Total had been excluded some time ago, in April 2007, Turkey placed significant obstacles to the participation of Gaz de France, at a time when ÖMV was seeking a partner with whom it might share costs, and that, mostly for political reasons: France was about

³⁴⁸ "Posledniaia nadezhda Nabucco (Последняя надежда Nabucco)", *Neftegaz.ru*, 8 July 2008 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³⁴⁹ Medetskii', Anatolii': "War casts cloud over pipeline route", *The Moscow Times*, 14 August 2008 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

³⁵⁰ Gabuev, Aleksandr; Solov'ev, Vladimir; Mustafaev, Rafael and Dvali, Georgii': "Dik Chei'ni oshibsia Kaspiem (Дик Чейни ошибся Каспием)", *Kommersant*, 5 September 2008 (Accessed on the 26th February 2013, from Integrum, Helsinki University).

³⁵¹ Gavshina, Oksana: "Nabucco dzhaz (Nabucco-джаз)", *Gazeta*, 10 September 2008 (Accessed on the 17th April 2013, from Integrum, Helsinki University).

³⁵² Grib, Natal'ia and Skorlygina, Natal'ia: "Turkmeniiia nashla gaz v obkhod Rossii (Туркмения нашла газ в обход России)", *Kommersant*, 15 October 2008 (Accessed on the 26th February 2013, from Integrum, Helsinki University).

to approve a bill calling the mass killing of Armenians by Turkey during World War I, a genocide.³⁵³ Fears of depending excessively on Turkey (as would happen with Nabucco), might have been related to the idea of reviving the "White Stream", which would connect Georgia and Romania through the Black Sea.³⁵⁴ However, in 2006, Turkey had already threatened to gang-up with Russia instead and foster the expansion of Blue Stream, if the White Stream's competition moved on.³⁵⁵

With Russia signing in May 2007 an agreement with Turkmenistan and Kazakhstan for the construction of the Caspian Pipeline (see below), with Turkey's announcement in June 2007 of its project of South Stream (see former section, above) and with Turkmenistan coming closer to China, Nabucco seemed to be facing hard challenges. This succession of blows might explain why Turkey assumed a more proactive role, as when Ankara tried to entice Azerbaijan and Turkmenistan into Nabucco.³⁵⁶ Turkey even considered that Iranian gas, instead of exclusively supplying its internal market, could also be exported further to the West as far as Europe.³⁵⁷ In fact, an agreement was signed to develop the South Pars field in Iran and to export a yearly total of 30bcm of gas, 20bcm of Iranian gas and an additional 10bcm from Turkmenistan;³⁵⁸ Turkey was trying to resurrect the more ancient plans of transporting Central Asian gas through Iran and to establish the latter country as the main supplier to Nabucco. True, Turkmenistan's agreement had not been secured, whereas there was widespread scepticism among experts in the field, as to whether Turkmenistan could provide additional natural gas for Russia, China and Nabucco.³⁵⁹ Besides, as could be expected, the US soon voiced its opposition regarding the inclusion of Iran as part of any deal directly or indirectly concerning Nabucco.³⁶⁰

³⁵³ Dempsey, Judy: "Turkey aims to pressure Europe over gas pipeline", *International Herald Tribune*, 5 April 2007 (Accessed on the 26th April 2013, from Integrum, Helsinki University).

³⁵⁴ The election of Romania as opposed to Ukraine (a potential option for connections to the Caucasus too), which at the time might see its GTS penetrated by Gazprom (see chapter 7), was also supported by the US policy of reinforcing the Romanian port of Constanta; during that time, in fact, Romania, Serbia, Croatia, Slovenia and Italy approved the construction of an oil pipeline from the Rumanian port of Constanta to Trieste, in Italy. (see: Simonian, Iurii': "Tzughtzvang SShA v energogonke s RF (ЦУГТЦВАНГ США В ЭНЕРГОГОНКЕ С РФ)", *Nezavisimaia Gazeta*, 6 April 2007 (Accessed on the 26th February 2013, from Integrum, Helsinki University).

³⁵⁵ *Ibid.*

³⁵⁶ "Turtsiia aktivizirovala peregovory s Turkmeniei' i Azerbaidzhanom o marshrutakh postavok gaza (Турция активизировала переговоры с Туркменией и Азербайджаном о маршрутах поставок газа)", *RusEnergy*, 11 July 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³⁵⁷ *Ibid.*

³⁵⁸ "Iran and Turkmenistan to pump gas to Europe", *Oil and Gas Europe*, 16 July 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³⁵⁹ Kashin, Vasilii' and Reznik, Irina: "V Evropu cherez Iran (В Европу через Иран)", *Vedomosti*, 16 July 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³⁶⁰ "SShA protiv planov Turtsii po transportirovke turkmenskogo gaza v Evropu (США против планов Турции по транспортировке туркменского газа в Европу)", *RusEnergy*, 17 July 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

Turkey's attempts to revive the prospects of Nabucco by way of resurrecting the Iranian route were in vain. More ambiguous for Nabucco was the announcement in July 2007 of the agreement between Turkey and Greece and Italy to build the TGI Interconnector, also known as "Poseidon", with plans to export 8bcm per year to these two countries.³⁶¹ This could turn into a further blow to Gazprom, as it represented an additional plan to link Europe to non-Russian countries. However, the TGI Interconnector would also compete with Nabucco and deprive it of resources needed for its initial stages, as the main supplier for the TGI would be Azerbaijan.³⁶² Then Turkey's announcement that it intended to secure as much as 21bcm of natural gas that Azerbaijan might produce from the second stage of Shah Deniz exploitation,³⁶³ promised to conflict with the rest of Nabucco's partners. Turkey promised to re-export some of the Azeri gas obtained to Nabucco.³⁶⁴ However, Nabucco's plans were rather to export that gas directly from Azerbaijan.

Differences persisted between Turkey and Azerbaijan during 2008 which affected the prospects of Nabucco. Here again, the US was putting up as much effort as possible to enable both countries to agree.³⁶⁵ In spite of this, the EU could at least agree with Turkey where the pipeline would start,³⁶⁶ this being a sign of interest from the side of Ankara, even if it did not dispel Turkey's idea of becoming more than a transit country who intended to own some of the gas transited through Nabucco instead, to be later re-exported. Turkey tried to dispel doubts regarding its participation in the project, announcing in late June that an agreement for the pipeline's construction would be signed in the coming months.³⁶⁷

Nabucco squeezed between Russia's and China's competition

The complicated issue of securing resources from Nabucco once Iran dropped out of the list of potential suppliers (at least in the short term), with uncertainties regarding Azerbaijan and with the inherent difficulties of laying down a Trans-Caspian pipeline, was compounded by the fact that European

³⁶¹ Naumov, Igor: "Rossii'skomu gazu nashli konkurentu (РОССИЙСКОМУ ГАЗУ НАШЛИ КОНКУРЕНТА)", *Nezavisimaia Gazeta*, 30 July 2007 (Accessed on the 19th March 2013, from Integrum, Helsinki University).

³⁶² "Evropa bol'she ne nuzhdaetsia v rossii'skom gaze? (Европа больше не нуждается в российском газе?)", *RusEnergy*, 7 August 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³⁶³ "Turtsiia namerena preobresti 21mlrd kubometrov azerbai'dzhanskogo gaza (турция намерена преобрести 21млрд кубометров азербайджанского газа)", *RusEnergy*, 18 August 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³⁶⁴ *Ibid.*

³⁶⁵ "Mezhdu Azerbaidzhanom i Turtsiei' sushchestvuiut raznoglasiia po proektu Nabucco (Между Азербайджаном и Турцией существуют разногласия по проекту Nabucco)", *RusEnergy*, 5 March 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³⁶⁶ "Opredeleno mesto, s kotorogo nachnetsia stroitel'stvo Nabucco (Определено место, с которого начнется строительство Nabucco)", *RusEnergy*, 25 March 2008 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³⁶⁷ "Soglashenie o proekte Nabucco Turtsiia podpiset v blizhai'shie mesiatsy (Соглашение о проекте Nabucco Турция подпишет в ближайшие месяцы)", *RusEnergy*, 1 July 2008 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

countries were by no means the only competitors for Turkmen gas: China was arguably in a better position, but so was Russia. As it would soon become manifest, in spite of the multi-pronged EU strategy, including economic cooperation and rule of law promotion, its democracy and free-market based approaches put it at a clear disadvantage compared to other actors who were more pragmatic and better positioned.³⁶⁸

Russian efforts to secure its role of monopsonist

As we had the occasion to see in chapter 6, Russia started with a relative advantage in relation to Europe, not only because of the post-Soviet legacy of being the monopsonist for Central Asian gas, but because Gazprom seemed to be able to increase this role. Russia had signed in 2003 an agreement to increase its purchases of Turkmen gas, so it would become the sole buyer by 2007. As we know, Russia managed to purchase all Turkmen gas for 2006 already, depriving Ukraine's Naftohaz of its direct relations with Turkmenistan. Gazprom naturally wanted to secure Turkmenistan's natural gas production, which could explode as a result of South Yolotan's production, by upgrading the existing pipeline infrastructure.³⁶⁹ The Central Asia - Center pipeline, which connected Turkmenistan with Russia, had a capacity of around 40bcm and was planned to be upgraded to 55bcm per year by 2010, with the possibility of a future upgrade to as much as 90-100bcm per year.³⁷⁰ Russia's game in 2007 would be mainly concentrated on the possibility of reinforcing its monopsony.

Relying on a partner like Turkmenistan, ruled by the mercurial Saparmurat Niyazov, could become very frustrating for Nabucco (as previous chapters showed, in relation with Russia and Ukraine) and this proved a quite weak foundation for securing a stable long-term supply for the ambitious project. One blatant example of the kind of surprises that Ashgabat could reserve for Nabucco's partners was the proposal made in November 2006 to both Russia and Germany, to lay a new pipeline through Russia with the goal of reaching Europe and with a capacity of as much as 40bcm per year.³⁷¹ This bombastic project (which never saw the light) played in fact into the narrative dear to Russia, of reinforcing its monopsony and made Nabucco's position very uncertain, with the Turkmenbashi having stated they did not consider the possibility of building the Trans-Caspian pipeline and with the European Commission desperately

³⁶⁸ See, Marquina, *op. cit.*, pp. 58-61.

³⁶⁹ Prikhod'ko, Oksana: "Turkmenskii' prikup v gazovom rasklade (ТУРКМЕНСКИЙ ПРИКУП В ГАЗОВОМ РАСКЛАДЕ)", *Zerkalo Nedeli*, 7 December 2006 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

³⁷⁰ *Ibid.*

³⁷¹ Grib, Natalia: "Prezident Turkmenii nashel dlia Rossii dva Shtokmana (Президент Туркмении нашел для России два Штокмана)", *Kommersant*, 7 November 2006 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

trying to change course.³⁷² Even if Turkmenistan dreamt of ridding itself of Russia's influence, it seemed to be at the same time eager (quite inconsistently, may we add) to use its potential for diversification to secure suitable agreements with Russia as the best issue.

Russia also suffered the inconsistency of Turkmenistan's erratic changes in policy course and remained far from winning the game. As an example, Niyazov's death by late 2006 stoked fears in Russia about changes this might bring in current projects of cooperation in the energy field. His succession by Gurbanguly Berdimukhamedov increased the prospects of a possible change in Turkmenistan's diplomatic course and decisive influence on the country's energy policy. However, defining who would secure the price of Turkmenistan's yearned resources was determining, especially given suspicions that Turkmenistan did not in fact have enough gas for all, both Russia, the EU (and possibly, Iran and China too).³⁷³ As it was usual in the late Niyazov, he had pledged to maintain energy relations with Russia, while it had promised around a yearly 15bcm to the EU to be supplied through Nabucco.³⁷⁴

In his first meeting with President Putin, Berdimukhamedov did not promise to be an easy partner for Russia, rather in the line of his mercurial predecessor Niyazov: in what was probably meant to scare Russia into concessions, he proposed that the Trans-Caspian variant for diversification be seriously considered and discussed.³⁷⁵ However, a big victory, even if only temporary, was in the making for Russia, when the prospect of building a system of gas transportation along the shore of the Caspian Sea, for which Russia needed both Kazakhstan and Turkmenistan's agreement, started to take shape.³⁷⁶ Thus, while a summit was taking place in Warsaw, trying to extend the Odessa-Brody pipeline to Gdansk,³⁷⁷ with the expected participation of Poland, Ukraine, Azerbaijan, Georgia and Kazakhstan,³⁷⁸ Putin was making a tour in Central Asia with the goal of enticing both Kazakhstan and Turkmenistan.³⁷⁹

³⁷² Grib, Natalia and Zygar' Mikhail: "Smert' Turkmenbashi stavit krest na soglasheniakh "Gazproma" i Ashkhabada" (Смерть Туркменбаши ставит крест на соглашениях Газпрома и Ашхабада)", *Kommersant*, 22 December 2006 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

³⁷³ "Turkmenistanu mozhet ne khvatit' "golubogo topliva" (Туркмении может не хватить "голубого топлива)", *RusEnergy*, 23 April 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³⁷⁴ *Ibid.*

³⁷⁵ "Kto staroe pomianet (Кто старое помянет)", *Vedomosti*, 24 April 2007 (Accessed on the 18th April 2013, from Integrum, Helsinki University).

³⁷⁶ "Rossiia, Kazakhstan i Turkmeniia gotovy obsuzhdat' sozдание gasotransportnoi' sistemy (Россия, казахстан и Туркмения готовы обсуждать газотранспортной системы)", *RusEnergy*, 8 May 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³⁷⁷ This pipeline was working in reverse mode, transporting Russian gas to Ukraine, instead of using the port of Odessa to unload and then transport Central Asian oil to Europe.

³⁷⁸ Kazakhstan finally did not participate. Instead, Kazakhstan's president Nursultan Nazarbaev stayed at home to confer with his Russian homologue.

³⁷⁹ Grib and Konstantinov, *op. cit.*

The goal was scored when in a trilateral meeting in May 2007,³⁸⁰ with both Nazarbaev and Berdymukhamedov, the construction of the Caspian pipeline was decided.³⁸¹ Besides this, it was also agreed that the existing pipelines running through Uzbekistan and Kazakhstan would be expanded.³⁸² With a total added capacity of 20bcm per year, to be eventually expanded to 30bcm.³⁸³ This could serve a fatal blow to Nabucco, depriving it of a badly needed supply source, once Iran had ceased to be a serious alternative. As we could see earlier through chapters 6 to 8, Gazprom accepted price hikes for Turkmenistan, so the reclusive Central Asian republic could extract gains from reinforcing energy cooperation with Russia. True, Turkmenistan, faithful to its classical balancing strategy, did not refuse to continue its participation in the Trans-Caspian pipeline.³⁸⁴

In what appeared to be a clear victory for Russia, the agreement on the Central Asian Pipeline, which further deprived Nabucco of a potential supplier, Turkmenistan (and arguably, the only realistic source of supply), was signed in December 2007 between Russia, Kazakhstan and Turkmenistan.³⁸⁵ Even if these plans remained undefined in the next months, true to Turkmenistan's policy of not committing itself, by July 2008 Ashgabad nevertheless stated it would not take part in the construction of Nabucco.³⁸⁶ In September, Gazprom made a deal with Uzbekistan for the expansion of the Central Asian pipeline infrastructure to upgrade its transport capacity to 30bcm more per year.³⁸⁷

China in the background and a new threat to Nabucco

However, as the future would soon prove with the inauguration in 2010 of the first gas pipeline linking Turkmenistan and China, the latter and not Russia, promised to become the worse enemy for Nabucco and for all countries in the EU which supported the consortium as an alternative to dependence on Gazprom.

³⁸⁰ Marquina, *op. cit.*, p. 62.

³⁸¹ Elder, Miriam: "Putin lands a deal for Turkmen gas", *The Moscow Times*, 14 May 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

³⁸² *Ibid.*

³⁸³ *Ibid.* The Caspian pipeline, which in fact already existed with a minor capacity of 1-2bcm per year, would be expanded to 10bcm, while the existing transportation system through Uzbekistan and Kazakhstan was to be increased to 20bcm (see: Butrin, Dmitrii: "Karty, dengi i dve truby (Карты, деньги, две трубы)", *Kommersant*, 14 May 2007 (Accessed on the 21st February 2013, from Integrum, Helsinki University).

³⁸⁴ *Ibid.*

³⁸⁵ Dempsey, Judy: "Russia signs Central Asian pipeline deal", *International Herald Tribune*, 20 December 2007 (Accessed on the 6th April 2013, from Integrum, Helsinki University).

³⁸⁶ "Turkmeniia ne budet uchastvovat' v stroitel'stve gazoprovoda Nabucco (Туркмения не будет участвовать в строительстве газопровода Nabucco)", *RusEnergy*, 4 July 2008 (Accessed on the 22nd April 2013, from Integrum, Helsinki University).

³⁸⁷ Medetskii', "Putin clinches deal for Uzbek pipeline", *op. cit.*

In July 2007, Turkmen President Gurbanguly Berdymukhamedov planned a visit to China to discuss the conditions for selling gas to its big Eastern neighbor,³⁸⁸ and to make use of the immense potential it had if Turkmenistan wanted to rid itself of dependency on Russia. The goal of the visit, which had to take place from the 16th to the 18th of July, was to develop an agreement which had been signed in April 2006.³⁸⁹ The agreement in question planned the import by China of as much as 30bcm per year,³⁹⁰ starting from 2009.³⁹¹ As a proof of how successful the Central Asian-China vector would prove, Chinese CNPC started construction of the pipeline already in August 2007.³⁹² Plans for having the pipeline ready by 2009 were hampered by a series of disagreements that delayed its planned progress. This explains why the pipeline's completion was pushed further into 2010.³⁹³

The pipeline's completion might have eventually been pushed further beyond the new deadline, due to the difficulties of negotiating with Turkmenistan. However, the energy incident between Russia and Turkmenistan in April 2009, where an explosion interrupted the pipeline and damaged Russia-Turkmenistan energy trade, probably definitively convinced Ashgabad of the need to diversify away from Russia. Explaining this, would take us beyond our period under analysis. It suffices for us to know that China was arguably making the most successful inroads, inroads that would eventually (further) break Russian monopsony and leave European efforts to come to nil.

³⁸⁸ "Turkmeniia opiat' uvodit svoi' gaz ot Evropy (Туркмения опять уводит свой газ от Европы)", *RusEnergy*, 4 July 2007 (Accessed on the 19th April 2013, from Integrum, Helsinki University).

³⁸⁹ "Gazirovannaia strategii", *op. cit.*

³⁹⁰ "Turkmeniia opiat' uvodit svoi' gaz", *op. cit.*

³⁹¹ Heinrich, "Introduction: export", *op. cit.*, p. 56.

³⁹² *Ibid.*

³⁹³ Yenikeeff, Shamil M.: "Kazakhstan's gas: export markets and export routes", Oxford Institute for Energy Studies, NG 25 (November 2008), at <http://www.oxfordenergy.org/2008/11/kazakhstan%E2%80%99s-gas-export-markets-and-export-routes/>.

PART V: CONCLUSIONS

Chapter 11: Conclusions: Prospect Theory, the three Disputes and final comments

11. 1. Main Hypothesis and Results of the Present Research

As we highlighted in our first introductory chapter, the main hypotheses for our research were that Russia's decisions to either escalate or deescalate each of the three disputes were closely related to both the status quo in Russia-Ukraine relations and to the risk factor related to consumers in the rest of Europe with a component of both economic and political factors.

At this stage we may state that the dependent variable, variations in the process of escalation in the three disputes, were mostly influenced by the first independent variable; namely, a worsening status quo accounts for a tendency to escalate disputes from the side of Russia if objectives cannot be reached unless resistance from the side of Ukraine is broken. This would confirm what prospect theory expects in such situations.

Within the first independent variable, mostly economic changes in the status quo, even if political factors may have had a certain influence, are to be accounted as the main explanatory factor. As will be explained in detail below, this research has shown there is a very close correlation between changes in the Russo-Ukrainian energy relations, energy politics by Central Asian suppliers or the context of international energy market, that account for the three disputes. Political aspects do not remain absent, even if they are generally closely related to economic factors and cannot always be clearly distinguished.

Finally, as for the second independent variable, stemming from our hypothesis, this research did not find significant variations regarding the best measuring tool, that is, competing pipeline projects, that could lead us to state that they had any significant influence on the outcome of the disputes.

Chapter 9 summed up the results of the disputes and clarified that variations in the escalation of the three disputes were based on Russian decisions. This opened the ground for prospect theory based interpretations. Chapter 10 dealt with pipeline politics, completing thus the information this research was seeking in order to conclude what our final results are. We may thus further proceed with our final conclusions. These are explained further below.

11. 2. Russia's Attitude towards Risk and the Risk Factor

As we saw at the beginning, prospect theory's strength lies in its consideration of actors' perception of the status quo as located either in the domain of gain or losses. The theory expects actors not to take risks that may imperil a satisfactory status quo for the sake of gains, remaining thus risk-averse. It also expects actors to become risk-acceptant if the issue involves averting losses; risk-acceptant actors would assume risks more easily in order to avert impending losses linked to a worsened status quo. This Phd thesis tracks the process of escalation in the three energy disputes and compares it with the prevailing status quo. This should be an optimal way to determine whether Russia's decisions to either escalate or de-escalate in each instance, are related to pursuing gains or rather, to averting losses. The status quo here represents the first and main independent variable, from where we need to deduce Russia's risk attitude in order to explain the dependent variable: the patterns of escalation. Along with this, we tried to measure variations of risk itself through the projects of pipeline diversification that were fostered during the period 2006-2008. This represents an additional and secondary independent variable.

11. 3. Explaining Energy Disputes through Prospect Theory: Attitudes to Risk and Economic and Political Factors

As we could see in chapters 6-8, and as was summed up in chapter 9, changes in the pattern of escalation in each of the disputes do not respond to the degree of Ukraine's resistance but to the lesser or greater need by Russia to escalate in each case in order to attain its goals. Even if the analysis of the agreements reached in each of the three cases is a relatively difficult source to determine the exact dimension of gains and losses for Russia, we can state with a high degree of certainty, that the way disputes escalated cannot be linked to Russia's will to attain success at any cost in the face of a changing degree of resistance from the part of Ukraine. This is a good reason for analyzing the status quo and for considering whether changes in it modified the risk-attitude from the part of Russia and Gazprom.

As we already explained in our first chapter, in accordance with the summing up by Jack Levy, prospect theory could be roughly reduced to the three following theses: 1) instead of evaluating outcomes based on the net asset levels, understood as an objective reference, actors evaluate outcomes based on a reference point subjectively chosen. Risk attitudes do not need to be explained through the lenses of prospect theory, as depending on the nature of actors, some of them can be located in different degrees of risk-acceptance/aversion. Using the language of constructivism, we could argue that the construction of

the point of reference will always be, at least to a certain degree, constructed and therefore, subjective. Thus, emphasis of subjectivity regarding the point of reference does not need to be exclusively understood through the lenses of prospect theory. However, what is characteristic of prospect theory is that actors tend to change their point of reference according to changes in the status quo; 2) losses are exaggerated as compared to gains; and 3) the most relevant insight for our research, actors tend to be risk-averse regarding gains, and risk-acceptant regarding losses. The third point above means that Russia would not risk its status quo for prospective gains if satisfied with that status quo. On the contrary, we would expect Russia to run risks to prevent losses if it considered the status quo to be unsatisfactory. As we stated in the first chapter, we assume that risks derive from potential reputation losses Gazprom might incur if energy disputes provoke supply disruptions for which it might be held responsible. In our case, the status quo is a complex one, as there are both economic and political factors.

Economic Factors

As chapters 6 to 8 have shown, we have placed an intentional emphasis on the economic aspects, to which the biggest part of the chapters are devoted, with political factors being reduced to circumstantial mentions when needed. This is necessarily determined by the very aspect of the disputes, centering on debt accumulation, pricing discussions and the complex organization of energy trade, even if this should not prejudice us to assume exclusively economic factors as determinant. As necessary as these factors may be, they are not necessarily sufficient, as there is a large record of politicization of the economy of energy in the post-Soviet space.

The gap between Ukraine's prices and market prices

In the period leading up to the energy dispute of January 2006, oil prices had been increasing constantly during the whole decade. As a result of this, natural gas prices were increasing in Europe, where long-term contracts had been established. This soon translated into higher profits for the Russian Federation's budget in general, as revenues from oil exported by Russia increased. It also translated into higher profits for Gazprom, due to natural gas being pegged to oil. However, this also increased the opportunity costs of maintaining prices for Ukraine, which remained year after year lower than international prices. During 2005 this gap had increased to intolerable levels. As an example, in 2005, average prices for the CIS region were at US\$61tcm, whereas the average for Europe had already reached US\$192tcm. Prices agreed with Ukraine in 2001 were as low as US\$50tcm. In fact, being the largest consumer of natural gas in the region, Ukraine enjoyed the lowest prices, lower even than for Belarus or Armenia: US\$54.1tcm

for Armenia, US\$55tcm for Belarus, US\$65tcm for Georgia and US\$80tcm for Moldova. Besides this price gap, Ukraine represented in 2005 49% of Gazprom's sales to the CIS countries, with as much as 37.6bcm; Belarus in comparison, consumed 19.8bcm. The opportunity cost was very high indeed.

Gazprom announced in late 2005 a general revision of prices and expressed its intention of raising natural gas prices to market prices in the CIS region. This explains why Gazprom and the Russian government behind may have had a clear economic reason for updating energy prices for Ukraine. Seen from the lenses of prospect theory, the status quo deteriorated enough to encourage the Russian side to revise it, forcing negotiations and thus jumping on the occasion, when the new Ukrainian authorities proposed to revise transit tariffs; this initiated a dynamic of tense negotiations that could potentially (as indeed happened) lead to an energy dispute. Even if we have generally focused on the process of escalation from the moment that gas cut-offs took place, the truth is that previous negotiations also represent a pattern of incremental tension and can perfectly be explained in the same fashion.

Triangular negotiations between Russia, Ukraine and Turkmenistan

There was an additional element that can explain why in economic terms Gazprom could see its status quo clearly deteriorate. This element is closely determined by negotiations on prices of natural gas sold by Turkmenistan. As the thorough analysis in chapter 6 showed, both Russia and Ukraine were trapped in a triangle shared with the mercurial Turkmenistan, who arbitrarily modified agreements. The key here to understand how negotiations between Ukraine and Turkmenistan for the share of Turkmen natural gas imported by Naftohaz affected Gazprom is that the latter intended (and succeeded in) becoming the monoposony buyer of Turkmen natural gas and thus drove Naftohaz out of this market, in order to become the sole contractual supplier (either directly or indirectly through RosUkrEnergo). Gazprom needed Naftohaz and the leadership in Kiev to accept price increases in order that Turkmen gas prices could be matched. Russia would ultimately agree with Ashgabad for a price of US\$65tcm, whereas Ukraine expected (and in fact signed, if to no avail) for no more than US\$60tcm. It must be pointed out though, that contrary to negotiations for 2007, 2008, and probably 2009 too, Gazprom did not simply seek to force Ukraine to accept prices that absorbed both prices of origin and transport costs (around US\$30tcm) for Central Asian gas. With Gazprom demanding US\$160tcm first (a more than threefold increase from US\$50tcm) and US\$230tcm later for its own natural gas, the goal seemed rather to establish a pricing system in accordance with its goal of imposing market prices.

The January 2006 Dispute and the 4th January Agreement

There were obvious reasons from the point of view of Russia to start a dispute. However, after Gazprom cut off natural gas supplies, we know that Ukraine provoked gas disruptions that forced Russia to backtrack and then accept a losing compromise. How did the status quo change for Russia to explain this behavior?

When Ukraine responded to Gazprom's cut-off siphoning off natural gas, risks inherent to energy disputes took shape, with disruptions to third countries becoming a reality Russia had to cope with. It is fair to think that Russia's perspective was not the prospective gains of imposing market prices on Ukraine anymore. Instead, Russia had now to avert losses to its reputation provoked by the energy dispute itself. We must note here that the gap between market prices and natural gas prices for Ukraine, which prior to the dispute was perceived as in the domain of losses and thus increased Russia's risk-acceptance, switched now to the domain of gains when costs for imposing market prices increased. We consider that instead of establishing an unequivocal distinction between the status quo in the domain of losses and the domain of gains, these categories must be considered in relative terms. If the gap between prices worsened the status quo to the point of pushing Gazprom to risk an energy dispute, this was not significant enough to assume the reputational costs the dispute ended up provoking. The fact that Russia started being heavily criticized and the fact that Ukraine siphoned off more natural gas than was needed for technical reasons (see technical needs), probably played an important, if not determinant role in this change. In that respect, we consider the benefits of market prices for Ukraine were seen in this new context as gains for which further risk was not acceptable. Thus, Russia preferred to return to the status quo ex ante.

It is noteworthy that the agreement of the 4th January 2006 was financially a loss for Gazprom. Either this became acceptable for Russia in the face of losses for Naftohaz or given possible non-financial gains (see RosUkrEnergo), the latter being, in virtue of our analysis, quite unlikely. It is possible that overall, Russia accepted a certain loss in order to secure the status quo. The risk of suffering reputational costs as a result of an energy dispute probably weighed more heavily after this had in fact happened, than before. This necessarily increased Russia's risk-aversion and the acceptance of short-term losses (see the January agreement) rather than the risk of worse losses in the future.

The new Energy Framework from January 2006

During three years, from January 2006 to January 2009, Ukraine-Russia energy relations were based on a new framework, whereby RosUkrEnergo became the sole supplier of a complex and opaque mix of natural gas and where Russian natural gas was either absent or had a very reduced presence (see chapter 6 and summing up in chapter 9). During this period, the challenge was not so much to turn Ukraine into a supplier of Russian natural gas at market prices but rather to secure that Ukraine updated its import prices whenever producers in Kazakhstan, Uzbekistan and mainly Turkmenistan, decided to review their pricing policy. Ukraine's prospective resistance was potentially harmful for Gazprom. Even if RosUkrEnergo was the sole exporter of natural gas to Ukraine, Gazprom was the sole buyer of natural gas in Central Asian since the agreements to purchase Turkmen gas at US\$65tcm in late 2005. Gazprom purchased natural gas, which was sold to RosUkrEnergo and then either exported to Ukraine or re-exported to Central Europe, in coordination with Gazprom. In any case, it was Gazprom who had to agree on prices every year, without the assurance that Ukraine would subsequently accept them in addition to transportation costs.

However, negotiations for new prices in 2007 and 2008 were uneventful. Naftohaz and the new intermediary UkrGazEnergo agreed to purchase RosUkrEnergo's gas at US\$130tcm in 2007, from US\$95tcm in 2006, and then US\$179.5tcm in 2008. These price increases were harmful for Ukraine, who had already been forced in 2006 to pass on the cost of imported gas to consumers at home. The financial situation of Naftohaz worsened considerably under the strain of these new prices and the fact that profits from selling to the industrial sector had to be shared with RosUkrEnergo, with whom Naftohaz had constituted the JV UkrGazEnergo. Even if this did not represent a particular obstacle for the conclusion of new pricing agreements, as Chapter 7 clearly explained, debt episodes became more frequent in this period. This is important to highlight, as the key for the second energy dispute in March 2008 was the debt due to Gazprom indirectly through the confused chain of responsibilities from Naftohaz through UkrGazEnergo and RosUkrEnergo.

The March 2008 dispute: the road to the 12th February agreements

The second dispute that took place in March 2008 is different to those in January 2006 and January 2009. The obvious difference is the scope, which we have already mentioned earlier. However, the economic reasons for starting a new dispute are different in comparison with its predecessor, even if not so much

compared to what would happen some months later. The constitutive element of this new dispute was that it was exclusively based on debt owed to Gazprom.

The issue of debt, which had had its last episode solved in late 2007, was compounded by the controversy on Russian gas consumed by Ukraine in January-February 2008 due to undersupplying from Central Asia. This caused a flare-up of emotions in Ukraine where it was seen as a ruse from Gazprom to force Ukraine to consume more expensive Russian gas. Debt had accumulated from 2007, while the Ukrainian side refused to pay for Russian gas, proposing to pay for it at US\$179.5tcm instead of US\$321tcm, forcing RosUkrEnergo to assume the additional expenses. In the midst of this, the new government of Yulia Timoshenko, elected as a result of the last elections in October 2007 and succeeding Viktor Yanukovich, wanted to get rid of RosUkrEnergo and UkrGazEnergo, fulfilling what she could not, in her first stint as Prime Minister back in 2005. The fact is that this had economic significance for Gazprom, as any eviction of RosUkrEnergo could eventually make debts owed to Gazprom to remain unpaid. In addition to this, the new government wanted to revise transit tariffs, which had been set at US\$1.6tcm/100km and slightly raised to US\$1.7tcm/100km in 2008, to compensate the increase in prices for natural gas supplies, going as far as to propose a new transit tariff of more than US\$9tcm/100km. These plans represented a clear threat for Gazprom.

As a consequence of this situation, we can understand the linkage Gazprom made to debt recovery and normal natural gas supplies. Thus, Gazprom stated that in the event that the current problems were not solved, gas supplies would be reduced. Gazprom and the Russian government could perfectly see the situation as located in the domain of losses, due to the debt accumulation and to the threat that plans by the new government could bring prejudice. In fact, this was not the first time this had happened. As a response to the debt problem that had surfaced in late 2007, still under the previous government headed by Yanukovich, and which was eventually solved, a reduction in supplies was already invoked. It should not be overlooked that at the time, parliamentary elections had already been celebrated and the nomination of Yulia Timoshenko as Prime Minister, along with her government's prospective plans to revise the status quo in Russo-Ukrainian energy relations was expected. The decision to take the first step towards energy disputes that carried a certain risk for Gazprom, as seen in January 2006, can again be understood through the prism of prospect theory.

There seemed to be a solution found to this situation in the compromise subscribed to by the presidents' agreement of the 12th February between Vladimir Putin and Viktor Yushchenko. Besides opening up the perspective for avoiding prospective losses, it seemed Gazprom added new gains. The

elimination of intermediaries seemed relatively easy, as both sides had already expressed their desire to get rid of them and preferred their relations to be based on strictly bilateral frameworks between Gazprom and Naftohaz. This in fact was precisely what seemed to have been reached with a new company formed by the two state monopolies. This opened up the ground, as has been explained, to a greater presence of Gazprom in Ukraine's internal market. It could be argued that Gazprom added gains as a result of negotiations.

Opposition to the 12th February Agreements and the Road to the Dispute

As we know, Prime Minister Yulia Timoshenko scuttled the agreement, focusing on the increased role Gazprom was to assume in Ukraine's internal market as gas distributor. How did Gazprom arguably recalculate its position in relation to the status quo? As prospect theory shows, actors adapt faster to gains than to losses. This means an actor will more rapidly insert recently made gains into its status quo, whereas after losses, actors will probably continue for a long time taking the status quo ex ante as the reference point. A fastidious consequence of this, as Robert Jervis pointed, is that an actor challenged for recently made gains, has a high probability of seeing the loss of these gains not as lost gains, but a loss in its status quo. This could have an application in our research. There is a possibility that Gazprom did not see Timoshenko's move as a challenge to recently made gains, but a challenge to its status quo, if the Russian side considered these gains as already integrated in the status quo. This could be an explanation for Gazprom's readiness to reduce supplies by a total of 50% from 3rd to 5th of March.

Even if this possibility is worth considering, it is not the best candidate to figure as the reason for Russia's escalation. This is so for a simple reason: Timoshenko was nullifying recently made gains, but more important than that, she was going back to the status quo as before the latest agreement. This status quo bore in itself enough threats of losses to activate Gazprom's harsh response. Besides this, the linkage between the resolution of the debt dispute and natural gas cut-offs had been made already, as we saw, in late 2007. If that threat had been voiced after Timoshenko's scrapping of the presidents' agreement, then we would have a more solid ground for suspicion. This is however, not the case. In addition, it must be added that it is far from clear that Gazprom had made in that agreement as many gains as could be deduced from what was announced in its aftermath, especially given new versions that were manifested. Opacity in these matters is an unsurpassable obstacle at this stage. That said, the fact that the 14th March agreement also presented conditions more favorable to Gazprom than those finally fulfilled, makes this suspicion highly plausible.

In any case, Gazprom took the fateful decision to reduce natural gas supplies by 25% on 3rd March and then an additional 25% on 4th March, so the total cut-off reached 50%. As opposed to January 2006, Gazprom's cuts were progressive and did not go as far as imposing a total cut-off. The reason why this was so could be two-fold: 1) The stakes after all were not as high as in a dispute regarding pricing of natural gas. However, the fact that in January 2009 discussions on natural gas prices were intentionally blocked by Russia until a solution could be found for the latest debt episode is a reason not to underestimate the importance this had come to represent for Russia. A tougher attitude from the Russian side could be more understandable for January 2009 given that there were already precedents. If debt had become important enough to initiate a gas dispute, it might not yet have reached the stage to respond in the same manner as in January 2006 when risks loomed, as soon as Ukraine threatened disruptions. 2) In addition to this, it is plausible that Russia had become more careful and therefore more risk-averse as a consequence of the experience of January 2006, so even if the stakes involved in this debt disputes were similar for Russia to those involved two years earlier, risk aversion had understandably increased. These represent two explanations, either alternative or combined, to account for Russia's behavior in March 2008, where it eventually behaved as prospect theory would foresee for risk-averse actors.

As for the agreement that was eventually signed, it offered similar solutions to that of the previous month: both the debt issue and the controversy over Russian natural gas consumed by Ukraine were satisfactorily solved for both sides, with no losses accruing for Gazprom. Regarding the reorganization of the energy market in Ukraine and therefore Russo-Ukrainian energy relations too, the new agreement mostly agreed on what had already been determined by the two presidents, namely, the immediate elimination of UkrGazEnergo and implicitly, the suppression of RosUkrEnergo too; in fact, the memorandum later signed between Russia and Ukraine on 2nd October confirmed the liquidation of RosUkrEnergo in 2009, as ultimately effected and as already agreed in February. However, the new scheme offered to Gazprom as a compensation for these changes and the suppression of UkrGazEnergo, raises some questions.

If information provided on February's agreement is correct, instead of acquiring half of Ukraine's internal market (or the equivalent of half UkrGazEnergo), the agreement for Gazprom to sell as much as 7.5bcm in the internal market represented not only a diminishment compared to February, but a loss compared to the status quo ante. Bearing in mind that in fact Gazprom ended up selling only around 3bcm, Gazprom's presence in the Ukrainian market became only marginal. In this deal we may see a similar pattern to the case of January 2006. Gazprom may have miscalculated again to discover a

Ukrainian government more aggressive than initially thought and ready therefore to intentionally provoke havoc for the sake of gaining the upper hand and preferred thus to accept a losing compromise for the sake of ensuring stability in the future. However, we should not underestimate Gazprom's inherent interest in establishing strictly bilateral relations, in which case Gazprom might have considered it ended up reinforcing its interests, in a win-win arrangement.

Our analysis of how Russia's interest remained after this dispute must thus present two possible conclusions without one being able to ascertain which of them should hold the upper hand: 1) Either Russia, as a loss-aversion actor, acted the same way as in January 2006 and even accepted lower losses in order not to risk bigger losses; 2) or Russia struck a win-win deal with Ukraine, which by the way, in a similar loss-aversion fashion, protected the status quo from further threats.

The Dispute of January 2009

Our last dispute is easier than its two predecessors regarding the outcome, as the analysis of the agreement in the previous section yields a clear victory for Gazprom. At the same time, it also matches the worst status quo for Russia as far as the economic situation is concerned. After having reached its peak in June 2008, oil prices started crumbling under the influence of the Big Recession, whose onset could be already perceived. Natural gas prices which were pegged to oil in long-term contracts necessarily had to fall, and with it Gazprom's profits. It is therefore plausible to assume Gazprom perceived a radical worsening in the status quo and framed financial losses related with Ukraine as bigger. This prospect theory-based explanation would account for Gazprom's radically modified approach to the dispute. As we already know, not only did Gazprom not backtrack when Ukraine started siphoning off natural gas as a result of the cut-off, but it imposed a total gas embargo. Such a measure hardly helped Russia in its carefully staged rhetoric, days already before the dispute, warning of possible disruptions and putting the blame on Ukraine. In fact it justified the more blatantly anti-Russian rhetoric portraying Moscow as a bully willing to take consumers hostage. Gazprom did everything possible to expose itself to risks inherent to energy disputes with transit countries. Such behavior is coherent with countries who frame their status quo as in the domain of losses and become risk-acceptant.

We can find mainly two candidates for intolerable economic costs that might have pushed Russia to cut off gas to Ukraine and to escalate to the stage of provoking a total energy embargo. 1) The first obvious candidate, if we are to weigh Russian financial needs, is Central Asian gas supplies that Ukraine consumed. As had been the case for 2007 and 2008, Ukraine had to accept higher prices in the face of the

willingness of its suppliers to renegotiate prices. As we could see, the context of increasing world oil prices did not only affect Russia, but also Turkmenistan, Uzbekistan and Kazakhstan, who officially declared they wanted market prices. This meant either Ukraine would have to accept them, or Gazprom would have to assume the costs if no agreement could be reached. As it appears, prices agreed were US\$330tcm. 2) The second candidate is the same that had provoked the dispute in March 2008: debt. By late 2008 a new debt episode was unfolding and as was done before, Gazprom made a linkage to debt resolution. However, this time, the linkage was not exactly between debt resolution and maintenance of gas supply as some months earlier. Gazprom refused to continue discussions on prices for 2009 while debt was not solved. If no agreement could be reached on pricing by Year End, then gas supplies would be cut as in January 2006. It was an indirect linkage indeed which proved ominous, in the face of Ukraine's incapacity or reluctance to solve the issue soon enough to leave margin for negotiations.

However, the details of the negotiations are puzzling given the conditions Gazprom was offering. If Russia had established the debt linkage with the intention of boycotting negotiations, it is puzzling that Russia did not insist head on, on prices close to US\$450tcm. This was the price Gazprom indicated it would impose on Ukraine if negotiations on prices failed. However, an agreement could not be reached because Ukraine would not agree on the much lower figure of US\$250tcm, as it insisted on US\$235tcm as a maximum. A price of US\$250 could hardly cover prices for natural gas purchased in Central Asia, compared to US\$360tcm agreed for the first quarter of 2009. As negotiations regarding this were extremely opaque, complete certainty on the conditions discussed in late-hour talks is not possible. If we should look for clues to make sense out of Russia's motivations for offering such advantageous prices, we should highlight first that independently of Central Asian natural gas prices, market-based prices for Gazprom's natural gas sold in Europe could not fall by the first quarter of 2009 that much. Taking average German import prices as calculated by Pirani, Yafimava and Stern, these had reached in the first quarter of 2009 US\$398tcm. Even discounting transport prices, Ukraine could never have expected to be granted such advantageous prices.

Nevertheless, the benefit of hindsight provides us with a key for assuming the most plausible explanation to this puzzle. In fact, as the reader may have remembered, negotiations in late 2008 did not specify for which period of time prices in negotiation were to apply. The quarter-based system of calculation, proper of oil-indexed natural gas prices, was introduced in Ukraine as a result of the 19th January 2009 agreements. However, to date, negotiations on prices between Russia and Ukraine had been negotiated on a yearly basis. In 2006, 2007 and 2008, as Central Asian producers decided to raise prices

on a yearly basis, this made full sense. But in fact, even if Gazprom wanted to establish quarter-based calculations, a particular feature of the common method to determine prices enabled negotiators to know what would be median prices for 2009. Oil-indexed natural gas prices as determined in long-term contracts, thus following the Groningen model, usually establish a delay of either two or three quarters. Due to this, it is easy to estimate what prices for the next year may be based on current oil prices. If we take quarterly prices Ukraine paid in 2009, based again on information compiled by Pirani, Yafimava and Stern, we may calculate that the median price Naftohaz paid, was US\$259tcm. This almost matches prices Gazprom wanted in the latest stages of negotiations before 2009.

Thus, the effect of the economic crisis that was setting in was twofold: on the one hand, the strain on Gazprom and the Russian budget justified the assumption of risks, while the fall in prices guaranteed that relatively acceptable prices could be assumed by Naftohaz. The fact that prices similar to those discussed prior to the dispute were based on a discount from a price basis abusive for Ukraine, could point to Russia's decision to punish Ukraine for its resistance. In such a context as analyzed in our research, Russia could have framed Ukraine's resistance as a worsening of the status quo and reinforced the need to further compensate for an increased perception in the domain of losses through more advantageous conditions in the final agreement.

Political Factors

As seen in the section above, economic factors clearly hold the upper hand whenever it comes to link the status quo to Russian decisions in the energy disputes analyzed. If any changes in status quo did have an effect on Russia and on the monopolist Gazprom, these were arguably, as the reader may have perceived, economic factors. However, this is far from meaning that the economy was the sole factor responsible here. Far from that, politics seem to have been present, even if sometimes its influence may be more speculative than is the case with economic factors.

The first instance where we may reasonably speculate with the role of political factors is the worsening of relations during the year 2005. With the inception of Yushchenko's administration that year, precisely as a result of the Russian-backed candidate Viktor Yanukovich's failure to be elected through rigged elections after being confronted with the Orange Revolution, the political orientation of the country became antithetical to Russian interests. As we analyzed already, the gap between prices for Ukraine and European countries buying natural gas at market prices had been increasing constantly, so the economic reasons for revising prices was obvious. Thus if the political change in Ukraine's

government may offer an explanation, we should argue that it paradoxically triggered an attempt to depoliticize energy relations with the suppression of subsidized prices. That worsening conversations led Russia to offer worse conditions, thus presenting Ukraine with the prospect of undergoing a non-gradual transition, may be read in political terms. In particular, the increase from the initial offer of US\$160tcm to US\$230tcm may be seen as a punishment for Ukraine's resistance, especially given that the latter were probably clearly above market prices. In fact, in an interview in 2008, Alexander Medvedev himself, President of Gazexport at the time, expressed his surprise at this increase in prices, as he knew Ukraine would never be able to pay for that.

Politicization may be suspected in a new episode, this time when a linkage was established between the repayment of outstanding debts and the normal supply of natural gas. The first instance when this was made was in late 2007. The second time this happened, this actually led to the threat being effected, provoking the March 2008 dispute. Both instances actually coincided with the return of Yulia Timoshenko as Prime Minister. Thus a political linkage may be easily suspected. The economic element though, is clearly present, as we already discussed. In fact, the linkage in late 2007 was made while Timoshenko had not been elected yet. The debt episode that triggered threats to reduce natural gas supplies happened, and was eventually solved, while Iurii' Boi'ko was still Minister of Energy. This was probably linked to the fear of Timoshenko's return as a factor that might lead to greater resistance to debt repayment, as in fact happened in the following year. Thus, even if we could not reject a political factor outright, we must be careful when it comes to assigning political factors to these episodes, as rather than a clear political linkage from the part of the Russian side, it seems that a political change in the Ukrainian government led to increased fears of economic losses.

The third time politics became a valuable candidate to offer an explanation for the energy disputes in discussion here, is a derivation of the linkage made in the March 2008 dispute. A linkage was made between debt repayment and negotiations on natural gas prices for 2009, which as we say above, led to a perfect storm. Again, we face the fact that the same political actors, Viktor Yushchenko as President and Yulia Timoshenko as Prime Minister, remained in place during this period, raising questions again about the possible politicization of energy relations between Russia and Ukraine. As in the case with the first episodes of linkage regarding debt repayment, we may find economic reasons for explaining Russia's hardening. Along with this, it is true that the August 2008 war between Russia and Georgia worsened the political situation and might have exacerbated Russia's feeling of siege. The fact that Ukraine expressed its explicit support for Georgia and even threatened to block the Russian Black Sea Fleet based in the

Peninsula of Crimea and thereafter warned of increased fees in exchange for the right to use the port of Sebastopol, in what seemed a clear political retaliation, offers a good candidate. It is nevertheless true that the linkage existed earlier and although the new type of linkage happens thereafter, our analysis in chapter 8 does not provide solid evidence that these events triggered it. In fact, still in early October 2008, the two Prime Ministers, Vladimir Putin and Yulia Timoshenko, signed an optimistic memorandum, whose prospects were clearly spoiled once debt issues resurfaced. Still, as for the abusive price basis for Ukraine in the 19th January agreement, a strictly political punishment cannot be excluded.

10. 4. Attempting to Measure the Risk Factor

The former section above summed up the most essential part in our research, as it concentrates our main conclusions. Focusing on changes in the status quo and matching these with different escalations in our three energy disputes yielded important conclusions. As prospect theory foresees, Russia reacted in a different fashion depending on differing perceptions of risk. However, this should be complemented with an analysis of the risk factor.

Prospect theory offers as an interesting insight that depending on the perception of the status quo and its valuation as in the domain of gains or domain of losses, the attitude towards the same risks changes. These changes happen in spite of that risk remaining constant. Adding the factor of changes in the perception of risk itself to the equation could help us expand our understanding of how disputes took place and in what measure these changes might have exerted an influence. The material for this can be found in chapter 10. However, as we could see in that chapter, the elements for measuring an objective variation of risk, in the assumption that Russia would perfectly perceive these changes, are scarce, and where present, quite imperfect.

In our research, for the reasons already described in chapter 1 and 10, we decided that the best element for measuring the existing risk in energy disputes was how energy diversification projects, which in themselves carried explicit conclusions as to who represented a challenge in EU-Russian energy relations, fared. While Nabucco implies that the EU has to reduce its dependence on Russia, two more projects, Nord Stream and South Stream, promoted directly by Russia, clearly implied that transit countries are the problem. It is therefore safe to conclude that these energy diversification projects represented the best way to determine in what measure Russia could assume that disturbances derived from energy disputes would backlash and affect negatively its energy policy.

The results of the analysis undertaken in chapter 10, starting from the assumption then, that progress in these three pipelines was determinant, cannot offer any conclusive answer as to the increase or decrease in objective risk.

From the positive side, Russia saw from 2006 onwards that Nord Stream could be successfully reactivated. Especially positive for Moscow was the fact that a key country like Germany, seen by Russia as an important ally in Europe, the main consumer for Gazprom, and the eventual destination of Nord Stream, did not move away from this project. In spite of Germany's conservative turn after the 2005 parliamentary elections, a consensus remained in favor of this project. Besides this, the business community was very actively supporting Nord Stream, while Gazprom could count on the European Commission's commitment to confirm the project as a EU priority project, as had been agreed back in 2000. That said, until the very end of the period analyzed, Russia could not count on a definitive confirmation that Nord Stream could be built. The ecological opposition from Baltic riparian states, such as Sweden, Finland, Denmark and more fatefully, Estonia, hung over Nord Stream. By 2008, Russia had not been able to reach an agreement with any, as no positive ecological assessment had happened yet.

Regarding Nabucco, Russia could interpret negatively the fact that this project was also spurred by the natural dispute of January 2006, with the European Commission establishing it as one of the priority projects. However, if troubles faced by Nord Stream were significant, no less difficult was the prospect of success for Nabucco. It could be argued in fact that Nabucco faced worse prospects than Nord Stream. The benefit of retrospect seems to reinforce this perception, as by 2011-2012 Nord Stream was fully completed, whereas Nabucco has not been built yet. The fact is that the most promising and geographically accessible supplier, Iran, was excluded from the beginning because of the US opposition. This also excluded Iran as the easiest transport route for the other promising alternative: Turkmenistan. With Iran out of the game, the consortium of Nabucco had to rely on the difficult Caspian route, marred by legal obstacles. As the Caspian Sea's division had not been agreed yet, Russia was granted a big influence, so it could block the construction of a Trans-Caspian pipeline. Even worse, Turkmenistan was a voluble partner, with plenty of competitors to Nabucco at hand, namely, Russia and China. The news that Turkmenistan had in fact huge reserves was not known in this period, so this competition represented a serious challenge for the whole project. Compounding all this, other minor partners, Azerbaijan and Turkey, who were necessary transit countries, posed several problems. Azerbaijan was necessary to kick start Nabucco, as it could secure the first shipments of natural gas while the Turkmen route was being built. However, the truth is that Azerbaijan did not offer any reliable perspective of sufficient supplies.

Turkey as a transit country was somewhat troublesome, insisting that some of the gas transited should become its property, and thus making negotiations difficult. If all this was not enough, South Stream, the second project of Gazprom, lurked in the background.

The record of South Stream is the most modest among all three projects considered here. No big defining success was ever achieved by this joint project between Gazprom and ENI. However, given the state of indeterminacy that pervaded the whole project, it may be assumed that it did a very good job convincing many Central European countries to participate in it. The fact that countries like Austria, Hungary, Bulgaria and Greece were either strong supporters of Nabucco or countries poised to benefit from it, and still at different degrees provided substantial support to South Stream, may be seen in itself as a victory. If the goal of South Stream was to undermine Nabucco's already lackluster prospects, it may be argued that it was delivering in a quite satisfactory fashion.

What conclusions may be extracted from the evolution of these three projects? We could argue that in general, prospects looked up for Russia, even if in general, the situation remained in limbo. It is important to note that up to the dispute of January 2009, Russia had no assurances that its flagship project, Nord Stream, would succeed. Even if this was partly compensated for by the worse prospects of Nabucco, in which Moscow could arguably count on South Stream to reduce or undermine it, it is evident that the situation had not radically changed in favor of Russia by 2008. If anything, it may be said that Russia secured a similar balance to that before the January 2006 dispute, so risks should have remained similar. Did however a perception of a slight balance in favor of Russia have influence on a higher degree of confidence? This may not be ruled out, even if we should not assign a particularly big influence to this. The fact that Gazprom behaved carefully in March 2008 and responded aggressively some months later, while no substantial change in the "pipeline front" had taken place, reduces substantially the explanatory power of this variable.

11. 5. Final Comments

Summing up, we may conclude that regarding the independent variable, variations in the process of escalation in the three disputes were mostly influenced by the first variable. Mostly economic changes in the status quo, even if political factors may have had a certain influence, are to be counted as the main explanatory factor. As for the second variable, variation of risk, we have found that this should be a relatively limited factor, if it had any influence at all.

This research stemmed from the consideration of what might have provoked a dispute like the one in January 2009. Highlighting in the beginning that dispute made sense, as this was the most extreme dispute that ever happened in the triangle between Russia, Ukraine and Europe. This was mostly so due to the repercussion of these cut-offs on third consumers. As for the length, a new energy dispute, not included in this research, happened in 2014 which lasted several months, but did not transcend Ukraine's borders and did not cause undersupplies in Ukraine either. As we have had the occasion to see in our first chapter, January 2009 culminated a period of turbulence, where three energy disputes happened. Excepting March 2008, which was relatively uneventful, January 2006 and January 2006 attracted much attention. The process of escalation that could be observed in the three disputes offered an interesting clue to consider what had provoked these variations and to answer what kind of actor Russia was. Prospect theory seemed to be the best analytical tool as it combines both deterrence theory and spiral logic. At this stage, this seems fully warranted.

One of the strong points in this thesis is that instead of focusing exclusively on the status quo as is usually done in most works that use prospect theory, the risk in itself has also been taken into account. The strength of prospect theory lies in its being able to offer an answer for why actors would change their risk attitudes and become more or less risk-averse depending on their perception of the status quo. However, this should not lead the analyst astray as to lose sight of one simple factor, which is the variance of risk itself. This adds further complexity to any analysis using prospect theory, as has been the case here. As we already concluded in the previous chapter, and as we reminded at the beginning of our conclusions here, we have found little support for linking risk variations in the escalation to the three energy disputes. However, the usefulness of having proceeded with the double analysis of the status quo and the risk factor itself is that we can satisfactorily isolate the factor of the status quo once the results have yielded no clear variation in the risk factor.

It is true that the most suitable factor we could find for analyzing the risk factor was a very imprecise one, as the progress of diversification projects in the EU, either favoring or being detrimental to Russia's interests. However our present research has the merit of having merged both analyses. This should be taken as an example for similar researches whenever the analysis is based on prospect theory.

Due to their effects on third parties, the disputes were interpreted in different fashion. We had the chance to see existing discourses in our literature review. These different interpretations reflect the general debate on Russian foreign policy. Our conclusions should be the place, finally, to take up the debate on Russia's characterization as an international actor after we can draw specific conclusions on the

three energy disputes. Our last section may be devoted to discuss Russia as an actor in international relations in the line of the different narratives existing regarding Russia. We may simplify them into two great poles, one portraying Russia as an aggressive and expanding power, the other as a conservative status-quo power reacting to challenges, rather than provoking them. As we had the occasion to see, these patterns are reproduced in the discussion on Russia and energy.

In general, we have shown that Russia behaved rather in a reactive fashion and the use of natural gas as a weapon of foreign policy was very limited at best. This research thus strongly supports the vision of Russia as a restrained power, as opposed to the narratives of energy superpower. This does not mean that Russia behaved fairly and that it did not seek to punish Ukraine when its resistance went beyond its patience. The abusive agreement of January 2009 may be the best example in this respect. Politicization seems to be present in many instances, as when Ukraine was treated abusively in 2009 or when prices had been kept subsidized before 2006 as it suited Russia. However, this happened in the context of economic interests, while the fear of energy disputes harming third actors and thus affecting Gazprom's reputation loomed large in most of the period analyzed here. Whenever Russia saw the status quo unfavorable, its risk-acceptance increased, and along with it, its aggressiveness. The findings here should be used to reject or at least nuance the classical view of Russia as a powerful actor, ready to behave aggressively and expand regardless of the consequences.

As for relations between the Russian state and Gazprom, they remain the most obscure point within this research. We devoted some of the literature to this topic already in chapter 2, which has dealt with the issue. We also described (pp. 49-50) how divergences between the state and Gazprom could be subsumed into our analysis, as changes in risk attitude could precisely have triggered reversion in hierarchy, although we may not prove exactly what the exact hierarchy was. A small evidence, not conclusive for its almost anecdotic presence, points both to divergences and to the ultimate subordination of Gazprom to the state, in the direction of what the literature review already showed in chapter 2. Declarations by Aleksandr Riazanov (Deputy CEO until being sacked in November 2006) in *Vedomosti*, where he explains how he opposed in 2005 the government's decision to modify the offer to Ukraine and to hike Gazprom's natural gas from US\$160tcm to US\$230tcm; it is interesting to know both that the government prevailed and that Riazanov was ultimately sacked in 2006.

Although again far from the degree of conclusiveness we might reasonably desire, the reader could nevertheless find as very instructive our discussion on relations between RosUkrEnergo and Russia, and our conclusion that the obscure intermediate hardly was a mere pawn of Russian interests. This must

be necessarily linked to our discussion of Russia as an international actor, for which this research offers a very useful case-study. Instead of a bully in full control of the situation and free to impose Machiavellian schemes that would eventually increase its power, we have found an actor, that may be Machiavellian indeed, but tends to reach compromises and sub-optima that prevent worse losses. The presence of intermediaries, whereof the most consummate creature is RosUkrEnergo beyond any doubt, seems to be a circumstance that may have favored Gazprom in different degrees. Nevertheless, these were deeply rooted in the corrupt panorama of Ukraine's energy policy and could not be rooted off completely until Gazprom fully imposed itself in January 2009. Until then, Russia seemed to be behaving in relatively conservative terms.

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